THE CONSUMER

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THE CONSUMER AND THE ECONOMIC ORDER

To

A. A. W.

and

D. J. C.

PREFACE

The ten years which have passed since the appearance of the first edition of this book have been a period of tremendous change. These changes have emphasized the deep concern of the consumer in the operation of the economic order. During the war it was necessary to supplant much of the ordinary operation of the economic system with direct governmental regulation, such as rationing, price control, and credit restrictions. The consumer and consumer problems necessarily received more attention than ever before. Broad issues regarding the role which government should play in consumption have been raised. Some have advocated a return to certain of the wartime controls. At times, and by certain groups, there has been a tendency to overemphasize special problems and to press for their solution. Frequently such emphasis is not wholly undesirable, since it brings public attention to bear on specific things which are often subject to remedial action. The broad implications of particular actions by specific groups however, should be clearly understood, as well as the ultimate results of various types of governmental activities. The successful operation of a democracy such as ours demands a well-informed body of citizens. The citizen should have a broad viewpoint as well as a recognition of the more restricted issues. This text is an attempt to provide the student with such a view.

Our debts to others are large. They have been acknowledged where possible, but undoubtedly some have escaped notice. The shortcomings of the book are, of course, our own responsibility.

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CHAPTER I

THE NATURE OF THE CONSUMPTION PROBLEM

There is an economy of consumption as important from the standpoint of human welfare as the economy of production. A large portion of the waste of our economic order arises, even after goods have been produced, from poorly arranged consumption, which not only results in a loss of satisfaction and enjoyment on the part of those who consume poorly but may also result in a misuse of productive resources as well. Acceptance of the thesis that the nature of man is, in part at least, a consequence of his environment gives a vital importance to consumption. Poorly ordered consumption will produce persons less vigorous and intelligent than will well-ordered consumption. Moreover, these effects will be cumulative; for not only will better consumption result in better individuals, but also these individuals, by virtue of their greater strength and foresight, will be able to provide better environment for their children, and these in turn will be better and stronger individuals. It is just as important, in consequence, for society to consider its consuming habits and problems as to take stock of its productive equipment. And, at last, the attention of many trained observers is being directed toward this phase of man's activities.

1. Some Problems of Consumption. Consumption is not entirely an individual matter. In fact, its most important phases transcend individual considerations. Consumption has, in other words, important social aspects. For example, much of what we consume is the result of the consumption of others. We often imitate others because we do not really know what to consume or because we wish to avoid being conspicuous through the omission of certain articles in our consumption. Moreover, if our incomes are small, our choice is limited largely to commodities that can be produced in considerable quantities because many want them. We also, in a small measure at least, contribute to the forces that determine not only the sorts of things upon which others work but also their conditions of employment. In so far as we spend our money on things that are produced

under conditions degrading and harmful to the workers, we have added something to the misery of mankind; and in so far as we spend our money for things that uplift and strengthen the character of the workers, we have added something to the general welfare of mankind. The extent of our responsibility in these matters is an ethical problem, and our point of view will depend upon the particular ethical theory that we hold. We all admit that in choosing a course of action it is reasonable to make some allowance for its probable effect upon others, as well as for its effect upon ourselves, but the importance of these two sets of interests is largely a matter of personal opinion. The effects of consumption, then, are not confined within the narrow limits of our own domestic establishments, but affect many outside these boundaries as well.[1]

Consumption is a very complicated process and covers a wide range of activities. What is more, we learn about it in many ways. Perhaps the most important method in the past has been through miscellaneous facts gleaned from other fields and through individual experience. Because of the importance and complexity of the subject, however, this method is no longer adequate. Consumption is a mode of life itself. As such, it is a problem in human behavior and in human motives and might seem more properly the field of the psychologist than of the economist. The economist, however, deals with a certain portion of the field of consumption, those aspects which are related to price, either directly or indirectly. There is nothing peculiar to economics in this method of approach. Precisely the same thing is done in sociology, political science, physiology, and other studies dealing with human beings. The economist does not suppose that these economic activities can be entirely separated from the rest of man's activities. The economist deals with man as he finds him, but concerns himself principally with this special sort of activity. The conclusions of the psychologist are accepted in all problems dealing with the relation of economic activities to other activities, *i.e.*, with the psychological basis of these economic activities, and the economist does not attempt to change them. In other words, the economist utilizes psychological precepts in his analysis wherever necessary. There is, on the other hand, a great deal of the economics of consumption that has no relation to any theory of psychology.

2. The Economics of Consumption. We may define economics, for our purposes, as the science that deals with the administration of

[1] See A. C. Pigou, Essay on Expenditure of Private Income, "Essays in Applied Economics."

resources in the satisfaction of human wants, in so far as this administration involves considerations of price or cost. Not all administration of resources is, of course, economic; much of it is technical and not a matter for economists at all. For example, the determination of the calorie content of certain foods, the setting of proper nutritional standards, and the proper preparation of food items are technical matters and are *outside* the field of economics. The calculation of the cheapest sources of certain necessary food elements and the variations in the prices of these sources are, however, *within* the field of economics.

Logically enough, the study of consumption should begin with production and distribution (in the economic sense) as a point of departure. Though it would seem to be something in the nature of a truism, much misunderstanding arises out of the failure to appreciate the fact that goods must be produced in order to be consumed. Some visionaries—Townsendites, for example—seem to labor under the impression that some sort of reallocation of purchasing power automatically brings forth goods and services sufficient for all. According to their scheme, oldsters would be taken out of industry and would be charged with the sole task of spending $200 each month. One wonders why, if such a scheme is sound, the age limit could not be dropped from sixty to, say, forty; why, if that were done, an era of prosperity such as we have never envisioned would not be forthcoming! The fact is, of course, that—just as in a family—greater average shares are possible only as greater income is produced.

The study of consumption economics is also predicated upon some understanding of distribution fundamentals. We should understand that in a modified laissez-faire society such as ours the shares going to the several productive factors are determined, fundamentally, by certain laws. We know, of course, that the owner of land receives a differential called *rent;* labor, a *wage;* the capitalist, *interest;* and the entrepreneur, a residual element known as *profits.* In general, the amount of each share is dependent upon the supply of and the demand for the particular element involved. More specifically, rent is determined by the value of a locational or fertility advantage; wages, by the marginal productivity of labor; capital, by the degree of time preference and the risk involved; and profits, by fortuitous circumstances and the enjoyment of a monopoly or quasi monopoly by the enterpriser.

Consumption may be studied in one of three different ways: in terms of prices, of the goods and services received by consumers, or of

psychic states produced by goods received. We may, for example, examine and compare the expenditures or receipts of people and deal with these as matters of dollars and cents. These statements can be quite definitely made, since the monetary unit is the common means of expression used for all of them. Unfortunately, such statements will often fail to tell us what we wish to know and must be supplemented with additional data. We may, in addition, deal with consumption in terms of goods and services. Here, however, we find no common unit to which we can reduce the many things that people consume; and, since each person consumes a somewhat different set of commodities from anyone else, and even different commodities at different times, our comparisons become to some extent infeasible. The best that can be done is to take certain major items of consumption, get arbitrary measures for these, and make our comparisons on this basis. Thus we might adopt cubic feet of air space per individual and square feet of window space per individual as measures of the adequacy of housing. Finally, consumption may be studied in psychic terms. Here we have few if any measures, and our statements and comparisons can be made only in the most general terms and with carefully stated assumptions.[1]

Economics properly deals with only the first of these methods of approach. Unfortunately, however, a study of consumption considered from the point of price alone cannot tell us all we wish to know. Considerations of human welfare cannot be avoided in a comprehensive study of consumption, and, in consequence, the strictly economic study is expanded to include portions of the problems involved in the other ways of considering consumption. These are included always, however, with a view to explaining or clarifying certain aspects of the monetary relations of the problem. Thus, it is essential to make clear that a given quantity of money expended in different times or places usually purchases a different quantity of goods and services. It is essential to discover these differences, to measure them, and to determine the causes of the differences. Similarly, it is important to show that a given quantity of money does not correspond to a certain satisfaction and that people who consume the same quantity of goods fail to gain the same enjoyment from life. It is also important to show that there is no single exact way in which money can be spent by all consumers with each deriving the same enjoyment from those expenditures. What may

[1] For a very interesting attempt in this direction see E. L. Thorndike, What We Spend Our Money For, *Scientific Monthly*, Sept., 1937, pp. 226–232.

be a proper expenditure of money for one person may be quite improper for another when tested by the enjoyment obtained from that expenditure.

The treatment of consumption in this study is very broad. Although the subject of consumer buying (for example) is given some space, the most important aspect is that having to do with political, rather than household, economy. The economics of consumption, from a social point of view, is concerned with three major problems. (1) The first of these is the status of the consumer in the existing economic order. The present order has important relations to consumption. The goods that are produced depend upon the desires of certain consumers. At the same time, the economic order limits and conditions consumption in many ways. The quantities of goods that a person may command are limited by his income. His income, to some extent at least, is conditioned by the success or failure of certain national policies. His choices are materially influenced by advertising and salesmen. The range of choices depends, in a large measure, upon what others consume. In short, his income, choices, and activities are modified on every side by the economic order in which he finds himself. (2) There is the problem of the manner in which goods are chosen and the economic results of these choices. The explanation of the choice of goods must rest, in a major part, upon psychology. The economist deals primarily with the modification of these choices by prices and with the effect of changes in choices upon prices. (3) There is the problem of the relation of human welfare to wealth. This is frequently a matter of consumption in its desirable and undesirable modes. This, too, is a matter that must be viewed from the standpoint of society as a whole. In this phase, also, certain problems of social control and social betterment are recognized primarily as problems of consumption, since by such activities more and better goods and services may be extended to consumers or a proscription of harmful commodities and services may be effected. In other words, these matters come properly within the scope of economics because they impinge in an important way on economic activities. The principal economic problem in consumption, from an individual point of view, is the proper administration of the individual income. The economist does not have a great deal to say on this problem, for a great portion of the problem is technical in nature. Even here, however, guideposts can be erected. The economist can, in other words, point out general guiding principles and furnish information concerning the several technical aids that are available.

3. The Difficulties of Consumption. When we compare production and consumption in a historical way, important differences appear. The problem of the individual as a consumer is becoming more complex. The kinds and qualities of goods offered on the market are constantly increasing. As a producer, on the contrary, his task is becoming simpler; instead of producing a range of products, he is becoming usually a specialist in the production of a small part of a single article. His tasks as a producer have become fewer and specialized; his activities as a consumer numerous and complex.

The great development of technique that has taken place in production during the last century and a half has not been found in consumption. There are two principal reasons for this backwardness of consumption: (1) the very nature of the consumption problem makes it difficult to use exact measures for testing the results of individual expenditures; and (2) the home, which is the usual unit in consumption, is too small to function well economically.[1] In addition, (*a*) acquiring needed merchandise, using such supplies intelligently, and keeping results in mind is a very involved and time-consuming process, and (*b*) the housewife cannot very well be a specialist since she is typically required not only to manage the household but to serve as mother and mate as well. The businessman tests the results of particular operations by their effect on the profits of the business. Those actions or policies are deemed effective which result in larger profits. No such exact measure is as yet available for the household. The home is, of course, operated for the well-being of the family, but well-being is such a vague thing that results can be judged only in the most general way. Moreover, the small size of the household prevents the economical operations found in industry by largely preventing the use of laborsaving devices and by causing purchasing to be less scientifically done. The usual home is much too small to utilize laborsaving devices effectively. The machine is used only a small portion of its possible working time, and it must either perform a very essential task or be very cheap to warrant its installation. In industry, a machine will often be used 12 out of each 24 hours, sometimes even more. In the household, a machine may be idle 99 out of 100 hours. Industrial purchasing has been largely specialized in the hands of expert buyers. Purchases are generally in large amounts. Therefore, close attention to prices and elaborate

[1] See W. C. Mitchell, The Backward Art of Spending Money, *Am. Econ. Rev.*, vol. II, Supplement, p. 269.

examinations of quality are warranted, since the cost of such "selection techniques" can be spread over a large number of units. Household purchasing, on the other hand, falls largely upon the housewife, who not only buys in relatively small quantities but has many other complex problems and duties on which to spend her time. The two problems are essentially different. The purchasing agent in business is called upon to buy a more restricted variety of products than the ordinary housewife is called upon to purchase, and in consequence he can acquire a much more exact knowledge of the methods of determining quality and the markets than are available to the housewife. At best, she can have only a general knowledge of prices and qualities. Business throws no exhausting labor upon those who are called upon to make its decisions; the housewife, on the contrary, is engaged in manual labor a large portion of the day.

The consumer, consequently, requires information, education, and protection. He requires many types of information. For example, since industry is organized to break down his sales resistance and direct his expenditures into certain channels, he should have sound information about goods—what they will do and which are the best buys. During the past decade, much headway has been made in these matters. In addition, however, the consumer should be given proper guidance in educational matters. He should have extended aid in his thinking concerning the several social aspects of consumption in order to be able to distinguish between socially advantageous and socially harmful institutions. Advertising, for instance, when understood properly, has many desirable aspects. To be properly informed on such matters makes it possible for consumers more intelligently and effectively to exercise their franchise.

Consumer protection has been receiving increased attention of late, since it is recognized that certain practices which have an adverse effect upon real income, health, and even life itself are not readily discerned by consumers. Indeed, much has been accomplished in these matters within the past several years. So, besides information, the consumer requires protection in the form of certain circumscriptions and proscriptions. But the most important factor of all, perhaps, is education. That is to say, the consumer requires an intelligent outlook on matters of consumption. Since we are all consumers, each of us is concerned. It is the main purpose of this volume to furnish a point of view that will make for a more intelligent approach to consumer problems.

Questions

1. What activities, if any, now carried on in the home, would you expect to be undertaken on any considerable scale by businesses outside the home in the near future?

2. Is technological unemployment a real problem? Write 1,000 words on the exact nature of the impact of technological change. Would it be better from the point of view of the consumer if such changes were controlled?

3. Has the introduction of laborsaving devices lightened the work of men or of women more?

4. What are the factors that make it difficult to administer the household effectively as compared with commercial production?

5. Since production has to do with the creation of utilities, does it follow that consumption is merely concerned with the using up of want-satisfying goods and services? Why or why not?

6. Adam Smith said: "Consumption is the sole end and purpose of all production. . . ." Do you think this is a sound statement? Why or why not?

7. Some years ago Stuart Chase wrote a book called *The Tragedy of Waste* (The Macmillan Company, 1926). What is the relationship of waste and consumption? Discuss the soundness of Chase's thesis. Assuming that Chase was correct is the problem as acute today?

CHAPTER II

THE ORGANIZATION OF THE ECONOMIC ORDER

The particular task of any economic order is to secure the best possible adjustment between the wants of a society and the means of supplying those wants. Certain wants can be completely satisfied for all the members of society, as the means of satisfying those wants are supplied by nature gratuitously in sufficient quantities to provide each person with all that he desires. Thus there is, except in certain special cases, sufficient air, water, and such things so that each may possess all he wishes. There are a great many wants, however, that cannot be completely satisfied, since the means of satisfying them are limited. The economic order administers this latter situation.

This administration involves two things: (1) the wants of society and its various members must be rated upon some sort of basis, and the goods which are available for the satisfaction of wants must be distributed so that only those which have been judged to be more important are satisfied; (2) the order must assign the means of production to their various uses in such a manner that the goods which are necessary for the satisfaction of the selected wants will be most effectively supplied. This means that the production of goods should be carried on by the best available technical methods. Where a want can be satisfied in several ways, the order should secure its satisfaction by the way that most effectively utilizes its resources. The means of production are limited because of physical limitations in nature and because men do not like to work or to wait. The order must, therefore, determine who will work and who will wait and how much work and waiting each must supply.

"In modern society total production has never been sufficient to supply the desires of the people for consumption. Though a few people in each age have command of all the goods and services which the twenty-four hours of the day permit them to consume, the armies of the middle and lower classes have many unfulfilled desires."[1] In other words, our problem is not one of distribution alone but, even more

[1] R. A. Stevenson and R. S. Vaile, "Balancing the Economic Controls," p. 1.

fundamentally, one of production. An adequate supply of goods is the first essential in a program of increasing economic well-being.

1. Types of Economic Orders. Our own economic order is but one of a number of different types of politico-economic systems or orders through which economic activities may be directed. The purpose of all, as has been stated, is that of providing a system for indicating what should be produced and how the income produced is to be distributed. Under some types of orders, the system of organization provides for relatively little central control. Under others, a maximum amount of control is required. That is to say, some orders are semiautomatic; others are operated by central authority through a system of artificial controls. It is thought by the proponents of the former that a relatively great freedom of action makes for greater economic effectiveness; by the proponents of the latter, that efficiency necessitates circumscription of individual initiative. The following paragraphs, together with those in the next section, present a brief description of the several possible types. Later, the two opposing general types of systems are evaluated.

The Autonomous Order. "First, an economic order can at least be conceived in which goods needed by the individual are made available by his own efforts, unaided by his fellow men. Crusoe is represented as contriving to satisfy his wants, in so far as they were satisfied at all, almost wholly by the labor of *his own hands;* and it is possible that many hunters and explorers for a time approximate his condition. A pioneer or isolated settler also to a great extent produces the very things which he consumes and consumes nothing but what he himself produces—bakes his own bread and eats it, grinds his own flour and bakes it into bread, raises his own wheat and grinds it into flour. Such an order, where each man provides directly and entirely for the satisfaction of his own wants, may be called an *autonomous economic order.*"[1]

An economic order such as that described exists nowhere in modern society. Few would advocate such a system for purposes of efficiency since it would allow for no specialization. Indeed, the so-called *autonomous order* could be characterized as a sort of economic anarchism impossible of realization as well as economically undesirable both individually and socially.

Socialism. Socialism, in its broadest sense, means that the principal facilities of production are socially controlled and democratically managed for the benefit of society rather than for any one group of

[1] FREDERICK M. TAYLOR, "Principles of Economics," p. 17.

individuals. The most important aspect of socialism is that of the socially owned and controlled production system. It is thought by the advocates of such a system that not only would production be more efficient through elimination of competitive wastes and reduction of costs (due, in turn, to production concentration) but that the benefits which did result would accrue, not to a small group of industrialists, but to the masses. It is unimportant to the present discussion whether control is obtained in an evolutionary or in a revolutionary manner. Suffice it to say that the Fabians represent one school of thought, the syndicalists the other.

Usually when one thinks in terms of socialism (in contrast to communism, for example), one presupposes a society allowing for considerable freedom of choice in the selection of consumers' goods. In practice a certain amount of limitation on consumers' choices would obtain, however, since competitive offerings would be absent and since the central authority could be expected to prohibit the production of "undesirable" commodities. In theory at least, the exercise of authority in socialism does not become fully operative until the production system begins the task of transferring manifested wants into actual goods and services. The socialistic order is not necessarily totalitarian, although freedom of enterprise and freedom of choice are definitely circumscribed.

Under a more or less complete socialistic order, the price system would be materially altered, since state monopolies would control a large part of production; and, since production would be for the benefit of society, cost of production would become the major determinant of price rather than demand. In a socialistic order, a large percentage of incomes of the residual type would be done away with; practically all returns from the operations of the economic system would be in the form of wages or salaries earned. Social service would be expected to motivate the whole, rather than profits. Larger earnings would in theory accrue to the wage earner since it is alleged that the product would be greater and since a greater proportion would be distributed to wage earners.

Fascism. Fascism, though not strictly a type of economic organization, has many economic implications. Fascism, in one very important sense, is a reactionary politico-economic philosophy. It is definitely mercantilistic. For example, anything that strengthens the *state*—makes it more powerful—is proper; anything that weakens the state is improper. The individuals making up society, however, are of minor importance. Indeed, the state must appear important

in the society of nations, even if the individuals making up the population pay dearly for such a "front."

Both socialism and fascism advocate strong central control. Two important differences stand out, however. Socialism is a movement for the benefit of the masses; fascism has been a movement benefiting the upper and middle classes. Moreover, whereas fascism has as its primary end the strengthening of the state as such, socialism has the end of strengthening the economic well-being of the individual members.

The *modus operandi* of a fascist society illustrates its philosophy. Any type of disorder or confusion is considered wasteful and as tending to defeat the end in view. Thus there should be no "parliamentary obstructions." Hence, such democratic institutions as elections and freedom of the press and of speech are discouraged. The state even acts as "guardian" of labor and capital, outlawing strikes and providing courts to handle industrial disputes. Since democracy is considered inefficient, the control of political and economic affairs is placed in the hands of one man. One man is more efficient, it is argued, since he can be more direct and has a clearer conception of the ends that are being sought.

Communism. In theory, communism differs from socialism in that the fundamental philosophy behind the movement ("from all according to their abilities, to all according to their needs") calls for arbitrary decisions concerning individual economic needs. Under such a system, in other words, society would have absolute control over consumption requirements as well as over production facilities. There would be no wages in the accepted sense of the term; "dividends" from operations would be allocated in the form of goods. The more efficient the industrial system, the more would be available for distribution to the members of society. The chief motivating factor would be the desire on the part of the members of society to raise the general scale of living.

In Russia, the communistic economic order has not been attained. Indeed, there are grave doubts whether it ever will be. After the revolution in 1917, the first phase of development was definitely communistic. Goods and services (if available) were free to workers, surpluses being commandeered for the purpose. Soon, however, it became apparent that things were not working as expected. Industry and trade had come to a standstill. The masses were in dire want. Consequently, in 1921 the New Economic Policy was launched (NEP, so called), being a temporary reversion to limited freedom of enter-

prise. Industrial activity quickened with amazing rapidity, so that by 1927 leftist experiments became practicable once more. Central control was again tightened, and the first Five-Year Plan was launched almost immediately.

At present, the economic system existing in the U.S.S.R. is socio-capitalistic. There is little freedom in matters of either production or consumption in that country; a dictatorship of the proletariat is the controlling force. Industry is almost entirely controlled through state monopolies and cooperatives, and, though consumers are no longer allocated goods on a rationed basis, certainly only limited quantities, qualities, and varieties are placed at their disposal. In Russia, individual preference has little effect on the types of goods produced. Although some choices can be made (as among the limited numbers of varieties offered as well as among goods of distinctly different classes), decisions regarding the use of production facilities are made on the basis of what is best for the masses rather than on the basis of manifested preferences. It is thought that such central control makes possible a much more effective planning of production.

There seems to be a distinct veering toward the right under Stalin. One manifestation of this tendency is the establishment of a differential wage system for the purpose of stimulating incentive. Another is the establishment of the controlled-price system, one object of which might be that of indicating consumer preferences, which cannot be entirely ignored even in a totalitarian society. Institutions in Russia, however, are still for the most part socialistic in character. It has been said that the present phase is just a step in Russia's development; that, when concentration on heavy (capital) industry is no longer necessary, consumers' goods will become more plentiful and then the next step from socio-capitalism into communism can be made. The Second World War has slowed up this process, if indeed it ever prevailed.

2. The Nature of the Existing Economic Order in the United States. Our economic order provides for the direction of production and consumption through the medium of prices. Prices determine what is to be produced, who is to consume particular products, and when these products are to be used. For the most part, the process takes place spontaneously; *i.e.*, the formation of these prices and the effects of particular prices take place within the order itself and without direction by some outside authority such as the government. The order, in consequence, is often said to be automatically regulated. Persons are left free in most instances to make decisions on the basis

of the relative importance of their own wants and to secure the satisfaction of these wants so far as their income will permit. Businessmen are free on the whole to provide the kinds of goods and services that they choose. Laborers and owners of productive resources for the most part are free to sell their services or not to sell them, as they desire. Each is dependent upon the other in this general process. Most people produce only a small portion of the goods that they consume, and a great many consume only goods that are sold in the market for money, which, in turn, gives command over goods and services produced by others. Hence, our society has been called the individual exchange-cooperative type.

The motive that drives people to this cooperation is almost entirely selfish. We do things because it is to our individual interest to do them. Those who have goods and services to sell exact the highest prices they can. Those who buy purchase from the cheapest source they know, other things remaining equal. The persons with goods or services to sell, however, are somewhat restricted in the amount that they can charge for them, since others have similar things to sell. In general, no one is obliged to buy from anyone else; in consequence, the prices of one seller must approximate those of other sellers, or the goods cannot be sold. This is the result of what we call competition, and it is only where competition is effective that it is safe to leave the provision of essential economic services on this purely voluntary basis. The interest of a group producing particular products might be that of exploiting the consumers of those products. Competition, if effective, however, prevents this. The pitting of each against the other in an effort to gain trade tends to ensure the supplying of these goods by those who are willing to furnish them at the lowest price.

The prospective prices of products determine which will be produced. The order leaves men relatively free to produce what they wish or to work for whomever they choose. They may be expected, at least within the limits of their knowledge, to select their most profitable alternative. Those goods will be produced which promise the producers the most profitable returns. The laborer will work where he can get the most satisfactory return for his services. There is a tendency, as a result, for our productive resources to be assigned to those uses which will yield them the most. This cannot be perfect, since society is a dynamic, changing thing; but, as rapidly as errors of estimate are discovered, an attempt is made to correct them. The force that leads to this distribution of resources is again that of private

interest. We do the things promising us the largest personal gain. When there is an increase in the price of a particular product and as a result business becomes more profitable in a particular line, there is an expansion of production by the producers in that line and newcomers endeavor to crowd in. When the price of a particular product falls, some of the producers turn to the production of other things. Prices indicate to the producers the demands of consumers for particular products and changes in those demands. If consumers desire more of a product and are willing to pay a higher price for it, then the price rises in the market. If, on the contrary, consumers cease to care for an article, then it cannot be sold in such large quantities at the former price. The order provides, in this manner, for the production of goods which the consumers desire and for which they are willing to pay a sufficient price to induce someone to produce. The order also provides for changes in the quantities of the goods produced in accordance with changes in the desires of consumers for goods.

As has been suggested, price also regulates the consumption of goods by distributing these goods among the various persons who compose society. The cooperative nature of our society means that most of the goods produced must be sold to others and ordinarily, through competition, that all similar goods must be sold at approximately the same price in the market. Prices in the market must, in consequence, fall low enough to clear it of goods, and all those who are willing and able to pay the price may obtain them. If the quantity in the market is small, then prices may be high, and many either will not or cannot buy, the goods falling only into the hands of those who are willing and able to pay the higher price.

It is in this manner (rather than through arbitrary decisions as in the regimented society) that our economic system determines the relative importance of different wants. Through its system of rewards, society automatically weighs each individual and enables him to collect approximately the full economic value of his services; he is then able to command for consumption precisely the same amount of value that his services have been worth to others. If one contributes more than another in the way of economic goods, then society judges by this process that his sum of wants is of more importance than those of the less productive contributor. Within the limits of the income thus earned, he may rate and satisfy such wants as he wishes. Those who contribute a great deal are able to consume much. If society has provided all with equal opportunities, then each is said to receive all that his abilities and exertions are worth.

The fundamental tenets of the individual exchange-cooperative type of order might be summarized as follows:

1. There is no test of social worth superior to that of individual taste; hence, individuals are to be allowed freedom of choice as to consumption and production opportunities.

2. Under a system based upon freedom of contract, exchange, and enterprise, industry runs at maximum efficiency.

3. The recipients of the various productive shares will receive rewards according to their productive efficiency and competition will effectively control the amount of such rewards.

3. Criticism of the Operation and Philosophy of the Order. The existing economic order may be criticized on at least two bases. (1) It fails to function throughout in keeping with the philosophy that we have outlined as forming the fundamental basis of the order. For example, it may be argued that the rewards for efforts are not perfectly adjusted and that in many places competition breaks down. In other words, the competitive system does not operate effectively either because of monopolistic control or because of quasi-monopolistic control resulting from product differentiation, unfair methods of competition, or what not. (2) The general philosophy underlying its operation is faulty. For example, it may be argued that the rating of wants in terms of the amounts of contributions allows the irrelevant wants of the rich to be satisfied at the expense of vital wants of the poor, and again that the profit motive provides a biased and unsafe force for the general development of society, since it sacrifices the interests of the group for those of the individual.

Although these general criticisms carry considerable force, no one of intelligence proposes the complete and immediate overthrow of the existing order. It is worth while, however, to examine the system critically in order to determine its specific weaknesses and the various possibilities of remedial action. For example, we look for protection from the predatory interests of individuals through competition. In many cases, however, this protection has broken down. There are many fields of production that are clearly monopolistic. The railroads, public utilities, and a large and growing mass of industries supplying public services are already noncompetitive; their monopolistic nature is recognized; and society provides safeguards for the consumers by the legal establishment of "reasonable" rates and minimum qualities of service. In many other industries there are trusts, as well as less conspicuous organizations, such as trade associations, or even codes of ethics, which are designed to lessen the effect of com-

petition and to make industry safe for the businessman. In the labor field there are some strong organizations which occasionally have been responsible for stoppages in certain vital industries because of dispute. Although competition has not disappeared entirely, it has ceased in many cases to provide safeguards needed by society; in these cases there is occasion for control and regulation in the interests of society as a whole.

Even granting legislative efforts designed to offset certain economic irregularities, the underlying philosophy of the order also may be criticized. It is probable, for example, that the order does not result in rating men in the best possible way for society. It is possible for each society to select and reward those whom it deems of most value to it. It may be urged, however, that our system of rewards concerns itself principally with temporary contributions and leaves only slightly rewarded those who make the most lasting contributions to our advancement. Thus, the great contributions to science or even to the arts are likely to receive only small rewards, whereas the relatively insignificant and ephemeral contribution of the popular radio comedian, say, may yield large returns. Moreover, it is quite probable that the competitive system fails in many cases to deal out the exact rewards needed to secure the supplies of the factors of production that are necessary for the goods worth making. Those who possess exceptional ability are probably paid more than is necessary to secure their services. At the same time, those of small ability are often so poorly paid that their efficiency suffers as a result.

The basis of the justice in rating men as we do lies in the assumption of an equality of opportunity. The individual alone is responsible for his life, the argument runs. Given a fair start in life, competition ensures him equal chance with others, and if he fails to make a success, the fault is his alone. Opportunities, however, are far from equal. Those of great genius rise over every obstacle, but the majority of men are mediocre and remain in the class to which they are born. There is a scarcity of capable men at the top of each profession, since to attain this level requires the unusual coincidence of great ability, the resources needed for a lengthy period of training, and the opportunity. There is an immense fund of high ability that is never realized upon by society because it is never given the proper chance of development. The system results in a much poorer utilization of our human resources than is possible, and every effort should be bent toward bringing to light and utilizing these hitherto wasted resources.

The efficiency of the present order in its administration of consumption is also certainly open to question. It has already been suggested that the rating of men on an economic basis may give an unsound criterion of the value of their wants. The institution of inheritance enables some to consume much more than their personal contributions warrant. A man may personally produce nothing yet consume much, because his ancestors produced much and acquired a property control over productive resources. Indeed, this original control may have been acquired by fraud or downright thievery from society. The methods of the valuation of wants that the order sets up breaks down here. It is when we observe the extremes in the differences of income that this becomes most clear. We find the rich indulging in whims and often actually degrading consumption while the satisfaction of wants that are necessary for their own efficiency are denied the poor. Whatever the fundamental worth of this system of evaluation, there are grievous maladjustments. All these things are matters of grave public concern and unless properly handled may in time cause the collapse of the present economic system with a loss of all the virtues that it contains.

4. The Necessity for Regulation in the Existing Order. As has been already suggested, the purely individualistic system, though eminently just in abstract form, may be very unjust in its actual operation. Indeed, many injustices arise out of the competitive struggle itself. Hence, monopolies emerge, wage earners are exploited, and consumers are adversely affected. Other limitations to pure individualism arise out of a lack of incentive for furnishing certain types of services that are necessary to our modern society. Hence, our system of political economy is perforce a mixed affair; the direction of human activity and its accompanying use of resources are under *dual control.*[1] Part of the control emerges from the economic system itself, and part results from the imposition of artificial restraints by central authorities.

As has been previously suggested, there are certain forms of activity that cannot be left to individual initiative, for the reason that while they are collectively important they offer no particular incentive for an individual to perform them. Provision for the national defense, police protection, and even the education of the great mass of our citizens would not be undertaken except through governmental action. It is necessary, for similar reasons, to care for the physically and men-

[1] STEVENSON and VAILE, *op. cit.*, p. 7.

tally defective and to furnish numerous services such as mail distribution, highway systems, and navigation facilities. In addition, we have found it desirable to formulate certain "rules of the game" to which those who choose to engage in business activity must adhere. Thus we set up certain standards of proficiency as requisite to the entering of some fields, since we believe that such requisites protect society. We also set aside certain areas in our cities for home purposes, restricting manufacturing and trading activity to segregated districts provided for the purpose. We set up certain restrictions regarding the treatment of laborers, particularly with respect to working conditions, hours of work, and wages. We have even made some headway toward establishing standards of quality for certain types of goods.

Since ours is a system depending on competition to control prices, we have antitrust laws designed to make competition mandatory. Regulations concerning competitive practices are provided for the same purpose. In some instances, however, we recognize the advantages of monopoly by sanctioning publicly owned or publicly regulated business enterprises.

There are a great many cases, however, for which society either has not or had not until recently recognized a direct responsibility. The business machine, for example, leaves a constant stream of human wrecks by the wayside for whom until quite lately no one assumed responsibility. For one thing, new technological methods are introduced, with their attendant displacement of personnel.[1] There are also the inefficient and the improvident, the victims of the improvidence of others, or of misfortune (resulting from sickness or accident),

[1] The problem of technological unemployment, however, is quite different from what is popularly supposed. Displacement of personnel due to technological changes arises through improvements in techniques in going industries (utilization of automatic or semiautomatic devices in certain production processes) and through the passing of outmoded industries (*e.g.*, the carriage industry). Over a period of time, personnel adjustments take place as a result of increased production volume due to a reduction of prices, the labor requirements of new industries which are continually coming into existence, and the labor requirements of industries producing the machinery giving rise to the technological change. It is interesting to note that in the United States in 1900 we employed 38.2 per cent of a population of 76 millions, whereas in 1930 we employed 40 per cent of a population of 122 millions. There is no gainsaying the individual aspects of the problem, however. That is to say, workers are actually displaced at times and have difficulty in making the necessary adjustments. Indeed, some older workers find the adjustment impossible of accomplishment.

and those simply ground down by the wear and tear of machine tending. Until recently there has been likewise no social responsibility for the wreckage caused by the business cycle; yet it periodically paralyzes industry and entails heavy social costs. Men remain idle who wish to work, and as a result the product of society is much less than it might be. We find it necessary, therefore, even in an individualistic society, to depart from the general principle of *laissez faire.* Social responsibility in such matters,[1] though slow to be recognized in the United States, is at last being given attention.

Competition actually fails to provide adequate protection in certain cases where the consumers or laborers are ignorant. It may, in fact, act to their detriment. Where consumers cannot tell the quality of goods, there is a constant temptation to the manufacturer to adulterate or cut the quality. Indeed, competition may force him to do this very thing or be outsold by his competitors. A similar situation arises in the case of the laborer who is offering his services. Guards and safety devices are expensive, and the manufacturer who incurs extra expenses for them is at a disadvantage in the matter of costs. Though we have made some strides at setting things to rights in both cases, there still remain vast quantities of shoddy goods and injurious lines of work that turn out men at middle age with their productive powers seriously reduced.

5. Planning in an Individualistic Society. When a system of comprehensive planning is introduced into an individualistic society, difficulties are immediately encountered. The reason for this is that, in order to plan properly, one must be able to forecast with a considerable degree of accuracy; otherwise the planning activity is likely to be not only futile, but wasteful as well. But in order to know something of the needs of the future one must know what people are going to want—where they will wish to live, what they will desire in the way of food and other goods, the type of economic activity they will choose to pursue, etc. This knowledge is practically impossible to obtain in a society where people are free to do one thing today and another tomorrow as the spirit moves them. In order to plan intelligently, then, individual choice must be circumscribed. This is why planning can be accomplished perfectly for the inmates of penitentiaries, since they have no choice as to where they are going to live, what they shall eat, what clothes they shall wear, or anything else. This explains also

[1] The responsibility in this regard includes seeing to it that the individual's initiative is not impaired in the process of receiving aid. It takes wisdom to help those in need without weakening the moral fiber of the recipients.

why the Russians can have a plan;[1] actually they have as individuals little if any freedom of choice.[2]

Sometimes a certain degree of planning is substituted for the free play of economic forces in some places (*e.g.*, agriculture) even in a free society. Prices, instead of being allowed to fluctuate in response to changes in supply and demand, are manipulated either by control of supply or by setting up a system of governmental "loans" on commodities at valuations higher than the market price. It will be noted that, instead of an attempt being made to control demand, in this type of planning the problem is approached from the supply side. While a limited success can be expected to attend such planning in the short run (assuming that the end is to improve the position of agricultural producers at the expense of consumers), the longer run result of such a scheme is often the loss of part or all of the foreign market, which may be disastrous. Thus, as a result of such planning before the war, the overseas market for our cotton had declined considerably.

During the recent war a rather comprehensive system of planning was superimposed upon our individualistic society with a considerable degree of success:[3] in the five years from 1938 to 1943 industrial production just about doubled in the United States.[4] But war conditions require drastic measures and people understand that they must make sacrifices. The circumscription of choices (of jobs, food, transportation, housing facilities, etc.) which made this planning possible was tolerated for this reason. It should be pointed out also that war conditions are quite different from peace conditions because (1) the demand for implements of war, unlike that for peacetime goods, is insatiable and thus the problem of constantly shifting production emphasis from one field to another is not as great, and (2) the goods so produced are not subject to the whims of consumers who under normal circumstances might reject such offerings.

One must conclude that the applicability of the type of planning utilized in wartime has definite limits in an individualistic order. People used to living in a free society quickly lose patience with limi-

[1] The Russians pretend to laugh at our planless society. As an example of this see M. ILIN (Marshak), "New Russia's Primer."

[2] Among other books, see Victor Kravchenko, "I Chose Freedom."

[3] Although one could argue that this miracle of production was due much more to private industrial genius than to the coordinating efforts of planners. It is suggested that the student look into Donald M. Nelson's "Arsenal of Democracy," for a clue as to the relationship of industrial "know-how" and governmental coordination during the war.

[4] The Cleveland Trust Company *Business Bulletin*, Mar. 15, 1946, p. 1.

tations on choices which are imposed by the government on their economic activities in order to effect a complete planning program. In peacetime such limitations are difficult to enforce because: (1) there is no particular motive which impels people to sacrifice freedom of choice, (2) people do not always have confidence that those in governmental positions know what they are doing and thus suspect that many sacrifices may be for nought, and (3) they are afraid that governmental interference will be "camel-like" in its effect (*e.g.*, getting the head into the tent is only a starter). Thus, over-all planning cannot be expected to develop very far in a free society.

6. Comparative Efficiency of the Regimented and Unregimented Societies. As to the comparative productive efficiency of the two general types of economic orders—capitalistic and socialistic—one can make few conclusive statements. The reason for this is quite apparent. Although the economic progress of the several countries can be compared roughly as was suggested earlier, there are few cases, if any, of purely socialistic or purely capitalistic orders. In fact, although there was a time when capitalism and socialism presented a clear-cut antithesis, such is no longer the case. Capitalism is taking on more and more "the trappings of socialism," whereas socialistic patterns have taken on a large part of "the framework of capitalistic institutions."[1]

Moreover, there never has been and perhaps never can be a controlled experiment regarding relative efficiency of economic orders. Though it is incontrovertible that Russia has with its controlled order made phenomenal progress, no intelligent person can argue that once the direction was pointed some, if not all, such gains could have been made under an entirely different institutional setup. Probably much too much emphasis has been placed upon social institutions as a factor in economic progress and too little on national resources, technological developments, and the skill of labor.

Experience and logic do give us some valuable pointers with respect to comparative efficiency, however. In theory, at least, a centrally planned economy has many distinct advantages. It does make possible a reduction of waste motion. There are possibilities of reducing production and distribution wastes. A country can gird itself for war and carry through a Gargantuan program with tremendous enthusiasm. Moreover, security may be more effectively established in a regimented society. There are, on the other hand, limitations to such an institutional system. Rapid changes in technological proc-

[1] A. H. Hansen, "Economic Stabilization in an Unbalanced World," p. 324.

esses are incompatible with economic stability, since it is through technological change that economic progress arises. Regimentation with a view to security may tend to slow down the rate of progress. Although the freezing of an existing situation might undoubtedly result in security, there is a danger that it might by that very token slow down economic advancement. There is grave question as to whether a centralized authority would elect to scrap a well-established production program, say, in order to take advantage of newly developed techniques. If regimentation results in a failure to accept a change that promises increased product, the cost to society might be too great. In the totalitarian order the savings at any one stage of development might be more than offset by losses resulting from a failure to progress toward a higher level of efficiency.

There are, of course, other questionable aspects of the artificially controlled economic order. There is always the question whether one man or a group of men is foresighted enough to make intelligent decisions regarding the detailed workings of a vast economic system. Mistakes made by those in central authority stand out in bold relief, for the results of such errors are not offset by the opposing actions of others. Witness the ghastly situation arising out of a combination of the exportation of wheat (for the purpose of creating foreign exchange to be used in the purchase of capital goods) and the collectivizing of the farmers (with a resulting reduction of production volume) in Russia in the early 1930's. The famine that followed the twofold program was one of the worst ever experienced. One never knows, of course, whether such errors are inherent in an artificially controlled system or whether with experience the chance of such serious errors can ultimately be eliminated.

Life under a totalitarian order would be intolerable to those who have lived under a system characterized by an absence of restraint. It has been a common experience that liberty is not appreciated until seriously circumscribed. Moreover, though savings might well result from the regimenting of consumers and the dictating of requirements, it cannot be gainsaid that "variety is the spice of life." One could conceive of vast savings resulting from the establishment of a standard calorie diet, but one shrinks at the thought of living under such a rigid discipline. To put it in another way, though the modified individualistic society may not be the most efficient possible, it undoubtedly makes for the fuller life. In such a society one may develop his own talents in whatever direction he pleases and to the extent of his abilities. In a free society man is in control of his own destiny to a

large extent and it is never too late to find oneself. In short, in this type of society the individual is all-important, and he is free to engage in the pursuit of happiness as he sees fit.

That we have made excellent economic progress in the United States under controlled capitalism there can be no doubt. One index that is helpful in evaluating the results of our own system is that of the change in real wages in the United States. For example, real wages increased 200 per cent in this country in the 50 years from 1881 to 1931; 400 per cent in the 100 years from 1831 to 1931, for which comparable figures have been compiled. One may infer from this that the scale of living of wage earners has been tremendously improved during the past century. In Russia, though there is little unemployment, the scale of living is "usually lower than that of workers in America and Western Europe in such bread and butter things as food and clothing, housing and transportation. Indeed the 'abolition of unemployment' might be just as plausibly, although less pleasantly described as a mass conscription of labor."[1] Though one should avoid an attitude of smugness, one cannot but recognize that the economic system under which we operate has on the whole been very effective in terms both of income produced and of the worker's share of the product.

We have, however, come to a turning of the road in our economic development. Our people seem to have indicated a strong inclination toward greater security. Part of this feeling is due to the problem having been brought into bold relief as a result of a periodic bogging down of our economic machinery, part to the increasing consciousness of the wear and tear on industrial workers of a geared-up industrial machine, and part to a recognition of the fact that the price of economic progress is technological maladjustment. We have, therefore, made many overtures toward stability. But, as Professor Hansen warns, "We may quite conceivably find it increasingly apparent, as time goes on, that a high degree of stability can easily be purchased at too great a cost in terms of both freedom and progress. A complete autocracy which could dictate precisely what consumers must buy and which could order producers around like chessmen on a board, could without much doubt cure the evil of unemployment. But such an autocracy, whether capitalistic or communistic, would probably discover that this sort of regimentation is not the kind of life that western civilizations wish to live."[2] We probably cannot have com-

[1] William Henry Chamberlin, "Russia's Iron Age," p. 96.

[2] Hansen, *op. cit.*, p. vii.

plete economic security for individuals and the gains derived from economic progress. As a matter of fact, the advantages of security have possibly been overstressed anyway. What we desire rather, very likely, is freedom to strive toward the fulfillment of individually conceived and nurtured aspirations, even though success is not assured. And we must forever remind ourselves that though we should continue to strive for social improvement we must be resigned to the fact that a utopian order is impossible of realization.

Questions

1. How important is the organization of society as a factor in determining the productive efficiency of an economic order? That is, is the nature of the economic organization as important as natural resources? state of the arts? organization of the business unit? technical proficiency of workmen?

2. Who are the net producers in modern society? How many are there? What proportion of the population do they represent?

3. How much consumption is and should be provided in a communal way under state leadership?

4. Do you think that Russia's success or lack of success would be any different if the so-called individualistic type of economy obtained there? Why or why not?

5. It is said that the United States is tending toward socialism. Is this true? Is such a tendency desirable from the point of view of the consumer?

6. It is said that the regimented society is a depressionless society. Discuss this statement.

7. Are there any limits to the use of planning in a society such as ours? How in your opinion might we use it advantageously in our society?

8. How would you say consumption was affected by the restrictive activities of labor unions in regard to the amount of work done each day, the use of improved tools, the requirement that more men be employed than is necessary, etc.? Assuming that you do not approve of such activities, what would you advise as a remedial measure?

9. Write a paper based upon sources derived from the "Readers' Guide to Periodical Literature" on the Russian way of life, with particular emphasis on (*a*) the degree of freedom which prevails there and (*b*) the scale of living which the people enjoy.

CHAPTER III

INCOMES OF CONSUMERS

The economic organization of society on a pecuniary basis gives great importance to the money income of the consumer, since the possession of this money income gives him power to command goods and services in the market. Individual consumers are, in fact, aware of a consumption problem largely because of the limitation of their consumption which is imposed by lack of funds. They ordinarily think their problem would be solved if they could, in some way, secure a sufficiently large income. The market is uninfluenced by needs or desires unless they are expressed in offers for goods in money. Each dollar, regardless of the ethical or moral value back of its expenditure, possesses similar power in directing the productive resources of society. The goods of society go into the hands of those who can pay for them, irrespective of the real needs of the purchasers. The consumption problem cannot, therefore, be understood without a knowledge of the distribution of incomes among the members of society.

1. The Concept of Income. The most usual concept of income is that of money income. This consists of the monetary receipts for a particular period of time. The money income of the family for a year is the monetary receipts from all sources received by that family during the year. It includes the salaries or earnings of the working members, the earnings from property, gifts, etc.; in short, all sums, from whatever source, that become available during the period.

Income and consumption are not necessarily the same. There is a difference between total and consumed income. Persons with large incomes generally spend a smaller proportion of their incomes than do those with small incomes. A man with an income twenty times that of another is not likely to spend twenty times as much in consumption, but much less—say, ten times as much. Moreover, because one person or group has a larger money income than another, it does not follow that they are able to consume more in the way of goods and services. Certain goods and services may not be sold in the market, or, if sold, may sell for a lower price in one place than they do in another; as a result a given money income is able to purchase

more in one place than in the other. The difference appears sharply when the money incomes of cityfolk and farmers are compared. The farmer receives a great many things, such as fruits and vegetables, dairy produce, and the use of his house, which do not represent expenditures of his money income.

We may term the goods and services which a person has to consume his *real income.* The real income of people and their consumption are very similar, since savings are generally in the form of money and not of goods. Real incomes are, in consequence, of great importance in a study of consumption. When we endeavor to measure real incomes however, the same difficulties arise as when we endeavor to study consumption on the basis of goods and services. There is no common denominator to which this heterogeneous mass of things can be reduced. We can describe quite precisely the income of an individual in terms of units or pounds—in short, we can make a complete inventory of the things or services that he receives or consumes; but as between individuals our statements can proceed only in general terms. The best that can be done is to select certain significant items that are capable of measurement and, by weighing them arbitrarily, arrive at a general notion. Despite these limitations, comparisons of real incomes, particularly those dealing with consumption, are often desirable for many purposes, since they may yield even more pertinent information than the comparison of money incomes.

The income concept may be pushed even further, and income may be thought of as a flow of satisfactions received over a period of time. This may be called *psychic* income. We know little or nothing regarding the psychic income of individuals. The psychologists have provided us with no unit for the comparison of reactions, and, in consequence, statements regarding psychic incomes are merely guesses. We may suspect that the satisfaction which one person receives from a good is different from that of every other individual, or that psychic incomes are somewhat proportional to real incomes—our conclusions in either case depend upon our assumptions at the outset. We have, as an additional difficulty in income comparisons, the fact that the various concepts are neither proportional nor equal. Thus the same money income does not provide the same real income, and, moreover, is not likely to do so. Similarly, the same real incomes may yield quite different psychic incomes. In consequence, we can hardly solve one portion of the problem in terms of one sort of income and another part of the problem in terms of a different sort of income and make close comparisons. Comparisons can be made only in a most general

way, and then only when all the assumptions and implications are stated.

2. Estimates of the National Income. There are no adequate data on the real income of the people in the United States. Various estimates have been made of money income for the United States as a whole and for certain other countries. These permit comparisons between times and places when properly qualified. One of the important components of these estimates is that of the flow of goods and services to consumers. This consists of the sum of the money values of the goods and services sold in the market to the ultimate consuming units during the specified period. Usually included also are estimates for the special cases where consumers receive essentially the same goods and services without money payments, such as the produce from the farm used by farm families and the imputed rental value of owned homes. The total is thus a fair representation of the contribution of the economic order to the consumption of the specified period.

These money estimates are an incomplete representation of real income of the period because they include only the sorts of things bought and sold in the market. The production and services which the household performs for itself are omitted. These are important items in real income. Among them are the services of housewives, whose value was estimated by one investigator to have been about 23 billion dollars in 1929.[1] The imputed value of the services of durable goods other than houses was nearly 3 billion dollars in the same year. Goods and services bought and sold in the market thus fail to represent the real income of the community by a considerable amount. Furthermore, the proportion which they do represent will vary between different times and places.

Examples of estimates of the dollar value of goods and services purchased by consumers are shown for selected years in Table 1.

In the third column of the table the amounts are shown which would have resulted if the goods had been priced in each year at their 1940 prices. The reduction to terms of 1940 dollars provides a rough measure of comparative physical volume. It is at once apparent that, however viewed, the income provided by the general social economy even in good years, and in a country as prosperous as the United States, is small. Thus in terms of per capita income in 1938 it amounted to only about $500. This emphasizes the necessity for a

[1] Simon Kuznets, "National Income and Its Composition," National Bureau of Economic Research, vol. 2, p. 433.

TABLE 1. PERSONAL CONSUMPTION EXPENDITURES IN THE UNITED STATES*

Year	Current dollars, billions	At 1940 prices, billions
1929	78.8	64.6
1932	49.2	57.2
1935	56.2	57.3
1938	64.5	63.9
1941	82.3	78.4
1944	111.4	88.3
1947	164.8	103.6

* U.S. Department of Commerce.

much greater production before the level of consumption can be materially raised for the entire group.

Some idea of the composition of the stream of goods and services flowing to consumers is secured by examining the division into groups as has been done in Table 2.

TABLE 2. MONEY VALUE OF PERSONAL CONSUMPTION EXPENDITURES BY CLASSES OF GOODS*
(Billions of dollars in current prices)

Year	Total	Durable goods	Nondurable goods	Services
1929	78.8	9.4	37.7	31.7
1932	49.2	3.7	22.7	22.8
1935	56.2	5.1	29.4	21.7
1938	64.5	5.8	34.0	24.7
1941	82.3	9.8	44.0	28.5
1944	111.4	6.9	67.5	37.0
1947	164.8	21.0	96.5	47.3

* U.S. Department of Commerce.

Durable commodities, as is implied, are those with a considerable life, such as furniture and automobiles. Of the total expenditures by consumers on goods and services, about 40 per cent is accounted for by nondurable goods and a somewhat smaller amount by services. One is left with the impression that the current product of the economic order pretty largely vanishes during the year and leaves relatively little as an addition to our stock of consumers goods.

Not all the goods and services produced in the economic order are sold to consumers for their immediate consumption. Some of the

things produced are capital equipment, such as factory buildings and machinery. These are subsequently largely used to produce goods for consumers, but in their immediate form are unsuited for direct consumption. They are, however, part of the production of the particular year. The government also buys goods and services in the market. In peace times these goods and services are similar to the goods and services purchased by consumers. In time of war, however, the government purchases many things in addition, such as tanks, guns, and war equipment, which consumers would not buy under any circumstances. All of these things taken together constitute the gross national product of the particular year in question. Estimates for selected years are shown in Table 3. These data permit an esti-

TABLE 3. GROSS NATIONAL PRODUCT OF THE UNITED STATES*
(Billions of dollars in current prices)

Year	Personal consumption expenditures	Gross private investment†	Government purchases of goods and services		Gross national product
			Nonwar	War	
1929	78.8	16.5	8.5	‡	103.8
1932	49.2	1.0	8.1	‡	58.3
1935	56.2	6.1	9.9	‡	72.2
1938	64.5	7.4	12.8	‡	84.7
1941	82.3	18.3	10.9	13.8	125.3
1944	111.4	4.3	7.9	88.6	212.2
1946	147.4	31.2	9.6	21.2	209.3
1947	164.8	38.8	28.0	‡	231.6

* U.S. Department of Commerce.
† Includes net foreign investment.
‡ In these years government war expenditures are not separated from other government expenditures in the Department of Commerce statistics. War expenditures are therefore included in the nonwar expenditures for these years.

mate of where our national productive efforts went. The comparison of the personal consumption expenditures with gross private investment shows the proportion of our effort devoted to directly consumable goods and that directed toward the provision of means for later production. The comparison of purchases of goods and services by the government for war purposes with the gross national product indicates how much of our total effort was spent for war purposes.

In producing the gross national product certain of our resources were used up. Machinery and equipment, for example, were worn out. These had been produced in earlier periods and their contribution to

production is more properly credited to that period. If we are concerned with the net national product of a particular year we will need to deduct these losses from the gross national product of that year. These deductions are shown in the third column of Table 4. In some

TABLE 4. NATIONAL INCOME FOR SELECTED YEARS IN THE UNITED STATES*
(Billions of dollars in current prices)

Year	Gross national product	Capital consumption allowances	Indirect business taxes and related liabilities†	National income
1929	103.8	8.8	7.6	87.4
1932	58.3	7.7	8.9	41.7
1935	72.2	7.4	8.0	56.8
1938	84.7	8.0	9.3	67.4
1941	125.3	9.3	12.2	103.8
1944	209.3	11.8	18.2	179.3
1947	231.6	13.3	15.8	202.5

* U.S. Department of Commerce.

† Also includes minor items, such as business transfer payments, subsidies less current surplus of government enterprises and statistical adjustments.

years we add more capital equipment than we use up and there is a net capital formation. This may be seen by comparing the data in the third columns of Tables 3 and 4 for the years 1929, 1941, and 1947. On the other hand, in the years 1932, 1935, and 1938 we were using up our capital more rapidly than we were replacing it. Net capital formation means that in addition to the goods and services provided for consumers in that year we had acquired increased power to provide goods in some subsequent period. In the years of capital depletion, such as 1932, we were able to supply the goods and services reaching consumers only by failing to maintain our capital equipment. The more accurate estimates of capital formation are those for the two decades from 1919 to 1938. In this period the flow of goods and services to consumers accounted for well over 90 per cent of the net national product, leaving only 6 or 7 per cent for net capital formation. Nearly all the product of society goes directly into the consumption of the particular year in which it is produced. Even this low proportion which net capital formation constitutes of the total product has appeared large to some economists, their argument being that some of our economic difficulties may arise from excessive capital accumulation in the economy.

In addition to the deduction of an allowance for capital consumption from the gross national product in order to arrive at an estimate of the net national product, an additional deduction must be made because of the way in which the estimates have been built up. Personal consumption expenditures are estimated on the basis of current market prices to consumers. These prices include the various taxes which have been added to the price of the products at various stages of their production and marketing, and which taxes have been paid by businessmen to the government. If we add the cost of goods to the consumers and the expenditures of the government on goods and services there would be double counting, because this part of the funds spent by the government would already have been counted in consumer expenditures. Allowance for this has been made in the fourth column of the table. These two deductions from the gross national product, together with some minor adjustments, result in the net national product, or as it is sometimes called, the national income. This constitutes a money valuation of the goods and services of the economic order which may be attributed to the productive efforts of a particular period.

The progress of the economy over a period of time is frequently portrayed by comparing the money incomes of the country at different periods. From what has already been said, it is evident that important errors may be involved if these comparisons are used to imply similar differences in real incomes or relative welfares, disregarding even the impossibility of an accurate summation of money incomes. There is certain income that escapes both notice and assessment in any calculation of money incomes.[1] (1) There are the unpaid services rendered in the individual households. The services of the housewife as we have seen amount to, say, one-fifth of the value of goods and services sold in the market. (2) There are differences in the qualities of goods. The comparison of money incomes over a period of time fails to reflect properly these improvements. The workman now spends his income for commodities quite different from those for which the workman of 1850 spent his. Comparisons between countries are rendered inexact for similar reasons. (3) The money income fails to account for such things as leisure, more congenial occupations, improved personal relations, the growth of freedom, good government, and education. Leisure, for example, although not directly purchased, is nevertheless a quasi commodity and one to which people divert their consumption as their incomes

[1] See William Smart, "The Distribution of Income," Chap. XI.

become larger. It is a well-established fact that the high-wage countries and industries are the countries and industries of the shortest hours and at the same time those in which the least labor of women and children is used to supplement the family income. (4) There are certain items to be balanced against these uncounted items. A greater proportion of goods and services is now sold in the market than formerly. Similarly, although the number of hours of working has been lessened, there has been a speeding up of tasks. (5) The general level of prices, as will be subsequently pointed out, may have changed, and this can be only roughly measured over any considerable period. History cannot record nor statistics measure the precise difference between two periods or places; at best only a rough estimate based on plausible assumptions is possible.

3. Inequalities of Money Income. It is evident from common observation that large differences exist among persons and families in the amount of their income. Table 5 shows estimates of the distribution among families in the United States at several different periods. Even though the average level of income has increased the inequalities have remained. If the table had been drawn up in the form of single income recipients rather than families, there would have been a somewhat smaller proportion in the upper income brackets.

TABLE 5. PERCENTAGE OF FAMILIES AND AGGREGATE MONEY INCOME IN VARIOUS INCOME CLASSES, 1947, 1941, AND 1935–1936

Money income per family	1947[a]		1941[b]		1935–1936[c]	
	Family units	Total family income	Family units	Total family income	Family units	Total family income
Under 1000....	13	2	34	9	53	20
1000–1999.....	18	7	30	23	31	23
2000–2999.....	20	13	21	26	10	17
3000–5000.....	28	28	11	20	4	11
Over 5000.....	21	50	4	22	2	19

[a] 1948 Survey of Consumer Finances, *Federal Reserve Bulletin*, June, 1948.
[b] *USDA Misc. Bull.* 520.
[c] *U.S. Bur. Labor Stat. Bull.* 723 and 724.

These inequalities of money income arise from two principal sources—differences in innate abilities of individuals and differences in the inheritance of property and environment. Psychological

data indicate that people differ greatly in their innate capacities and that, if these capacities could be completely tested and compared, we would find people grouped around the typical curve of normal distribution regarding them. In this curve, the largest number would be near the center, and as capacities became higher or lower and we passed to the extremes, there would be fewer persons in each group. One would expect from the distribution of capacities that the income curve would be of similar shape. The table shows that this is not true and that the income curve is very one-sided.

The principal cause of the difference in these curves is inheritance. Those who have no particular ability may be high on the income curve through inheritance. The numerous moron sons of wealthy parents are examples. The inheritances that affect incomes are of two types—the inheritance of wealth and the inheritance of environment and opportunities. The effects of the inheritance of property are obvious: they increase the income of the inheritor with little regard to his ability. The effects of the inheritance of environment and opportunity are less obvious, but deeper and more important. A mediocre person raised in a superior environment, with good opportunities and assisted by the advantage of sound training, is assured of a place in a moderately high income group. It is true that low incomes do not necessarily mean poor environments for children and large incomes good environments. It is also true that especially gifted individuals push themselves to the top from even the lowest groups. But in general the income of the parents has a great deal to do with the environment and opportunities of the children. The importance of this point cannot be overemphasized, since, if it is true, it constitutes a serious indictment of our present economic system. If rewards and opportunities for development are largely matters of inheritance, then the system fails to make the best use of our human resources. It is, of course, the belief that larger incomes or better utilization of those incomes will make available latent abilities among the mass of those who constitute the low-income groups which gives the social importance to the study of consumption.

Wages are the principal source of income for the lower income group, and there is considerable variation among them. In all countries the lowest wages generally prevail in agriculture, and these are usually one-half to three-fourths of the wages of unskilled industrial workers. Living costs are usually less than in the city, so that real wages do not differ as much. There is a higher rate of natural increase of population in the country, with a labor movement toward

the city. There is also a large difference among industries, although less pronounced than that between industry and agriculture. Wages in mining and the textile industries are generally lower than the national average and in the construction industries considerably higher. Another important and fairly stable difference is that between skilled and unskilled labor. A normal differential in the United States appears to be about 30 per cent in terms of the average for skilled workers, but this may fail to account for the greater stability of employment in the skilled trades and hence be too low. There has been a tendency toward a lessening of this difference. Salaries, on the whole, are higher than wages, but here again the differences have tended to lessen. There are, of course, variations among individuals in their rates of pay even in the same general lines of work. The variations are greater among the skilled than among the semiskilled; among the semiskilled, again, they are greater than among the unskilled. The differences also tend to be greater among adult males than among women and children, and among those receiving piece rates as compared with time rates.

TABLE 6. AVERAGE FAMILY INCOME BY OCCUPATION IN THE UNITED STATES, 1935–1936*

Group	Average income	Number of families, millions
Business	$3,079	3.50
Professional	4,022	1.33
Clerical	1,901	3.60
"Other"	1,696	0.85
Wage earning	1,289	9.50
Farming	1,259	6.20
Relief	740	4.50
All families	$1,622	29.40

* SIMON KUZNETS, "National Income—A Summary of Findings," p. 16. Families above are covered in these estimates; single individuals and institutional population are excluded.

The average family income by occupational groups in the United States in 1935–1936 is shown in Table 6. The upper sixth of the income families appear to be predominantly business and professional. The incomes of wage earners and farmers appear to be about the same.

Incomes of business families averaged roughly two and a half times those of wage earners and farmers, and professional incomes were nearly three times those of the lower groups. These differences

seem certain to decrease in the future with the greater strength of labor unions and probable expanding aid to those desiring to prepare themselves for professional work. In this connection the conclusions of Friedman are of interest. "At present, the limitations on the number of persons in a position to enter the professions must be considered the basic reason for the difference between extra returns and excess costs; more basic even than the difference in ability needed. A sizable number, perhaps a majority, of all young men are unable to enter the professions because they cannot make the necessary capital investment or for other reasons. If these hindrances were removed, the reservoir of persons unable to enter the professions could surely furnish many persons as able as those who now embark on professional careers."[1] Society would evidently have much to gain by providing opportunities for such training.

Income per capita differs markedly from state to state. The range is from well below one-half of the country-wide average in Mississippi to over one and one-half times in New York. In general, a high level of income per capita in a state is associated with a high proportion of the population deriving their income from industries other than agriculture, and a low level with a dominant share of agriculture in the state's productive system. The difference between the incomes of people living on farms and in places of various sizes in one given section of the country is greater, however, than the income difference between areas. This is illustrated by the median incomes shown by areas and size of city in Table 7.

TABLE 7. MEDIAN INCOME OF NONRELIEF FAMILIES IN THE UNITED STATES, 1935–1936, BY COMMUNITY SIZE AND REGION

	New England	North Central	South	Mountain and plains	Pacific	United States
Metropolises	....	$1,730	....	....	....	$1,730
Large cities	$1,361	1,646	$1,484	$1,607	$1,544	1,560
Middle-size cities	1,326	1,370	1,271	1,571	1,392	1,360
Small cities	1,419	1,293	1,094	1,493	1,545	1,290
Rural nonfarm	1,457	1,163	1,159	1,341	1,433	1,210
Farms	1,184	1,236	780	860	1,349	965
Region	$1,230	$1,260	$905	$1,040	$1,335	$1,285

[1] MILTON FRIEDMAN and SIMON KUZNETS, "Income from Independent Professional Practice," National Bureau of Economic Research, 1945, p. 94.

There seems to be a fairly regular change in the size of income as we pass from smaller to larger cities. The reason for the low income of the South thus appears to be the dominance of agriculture, in which the incomes are materially lower than for other agricultural areas of the country.

The income of the individual in so far as it depends upon his own productivity shows a well-marked change with age. The normal course is a gradual increase from a low beginning to a peak in middle or post-middle age and then a decline until retirement or death. Table 8 gives the median incomes reported by the Brookings Institution for the Michigan Study of 1934. The peak of incomes for most groups appears to have been at about forty years of age. For clerical personnel it was between forty and forty-five, and with the professional group it was just below fifty years.

TABLE 8. MEDIAN INCOME OF EMPLOYED WORKERS IN MICHIGAN BY AGE AND CERTAIN OCCUPATIONS, 1934*

Age group	Professional	Clerical	Skilled	Semiskilled	Unskilled
15–24.........	$585	$631	$705	$505	$321
25–34.........	1,273	1,077	1,087	819	521
35–44.........	1,666	1,285	1,178	861	588
45–54.........	1,731	1,271	1,137	829	560
55–64.........	1,606	1,178	1,065	732	519
65 and over...	1,519	980	955	590	488

* M. LEVEN, "The Income Structure of the United States," p. 156.

4. Some Effects of Differences in Money Incomes. The social cost or loss resulting from unequal incomes becomes most apparent when the extremes of incomes are compared. On the one hand, senseless and often degrading luxuries are indulged in; at the other extreme, individuals lack the minimum necessary to maintain physical efficiency. Miss Stiebeling found that 61 per cent of the families in the lower income group of employed wage earners and low-salaried clerical workers in the United States in the 1934 to 1936 study had C-grade diets or diets that were deficient in some important elements.[1] Infant mortality is high in the lower income groups; housing is usually poor, with overcrowding and, in a large number of instances, failure to meet most of the accepted, even if arbitrary,

[1] HAZEL STIEBELING, "Diets of Families of Employed Wage Earners and Low-salaried Clerical Workers Living in Industrial Communities in Three Regions of the United States, 1934–1936," Bureau of Home Economics, 1937.

minimum standards. The study of wage earners and clerical workers in cities in 1934–1936 (U.S. Bureau of Labor Statistics) shows the group of families with a total annual unit expenditure of between $200 and $300 to have 1.12 persons per room. The families with $1,000 to $1,200 total annual unit expenditures had only 0.49 person per room.[1] In determining expenditure units the moderately active man was taken as a unit and each other member counted in proportion, making due allowance for the customary consumption of persons of different age, sex, and activity. There is little doubt that, so long as society's income as a whole is not diminished, within wide limits an increase of income enjoyed by the poor at the expense of a similar decrease in the income of the rich would increase the welfare of society.

The unequal distribution of income not only modifies consumption by giving some the power to consume more than others but also modifies the character of the goods chosen on each income level. This is due to the tendency of men to ape their superiors; thus, since consumption offers in many cases a very visible way of imitation, it leads to excessive indulgence. The rich, therefore, possess not only the power to consume more than the poor but also the power to modify materially the goods that are bought by the poor with their income.

An increase in the income of the poor, relative to the income of the rich, would affect industry by leading to a change in the various kinds of goods produced. There would be a smaller production of expensive luxuries and a greater production of necessary articles. "Rare wines would give way to bread and meat, new machines and factories to clothes and improved dwellings."[2] Goods that depend largely for their importance on the fact that few consume them would decrease in importance and price. Such things as diamonds would decrease materially in value.

Expenditures of consumers are usually not the same as their incomes, and this is particularly true if only a single year is considered. At all income levels except the very lowest there are some families who save at least a little. At all income levels, even the highest, there are families whose expenditures exceed their current income at least for a time. Taken as a group, those with low incomes

[1] Faith M. Williams and Alice C. Hanson, "Money Disbursements of Wage Earners and Clerical Workers 1934–1936," *U.S. Bur. Labor Statistics, Bull.* 638, p. 95.

[2] A. C. Pigou, "Economics of Welfare," 2d ed., p. 76.

spend more than their incomes. They resort to borrowing, relief, gifts, or draw on previous savings to make up the difference. As a group, those with the higher incomes have savings, the amount increasing with the income of the group. Figure 1 indicates the savings and deficits for selected groups in 1935 and 1936. The difference in the savings pattern of these groups is striking and appears to be due

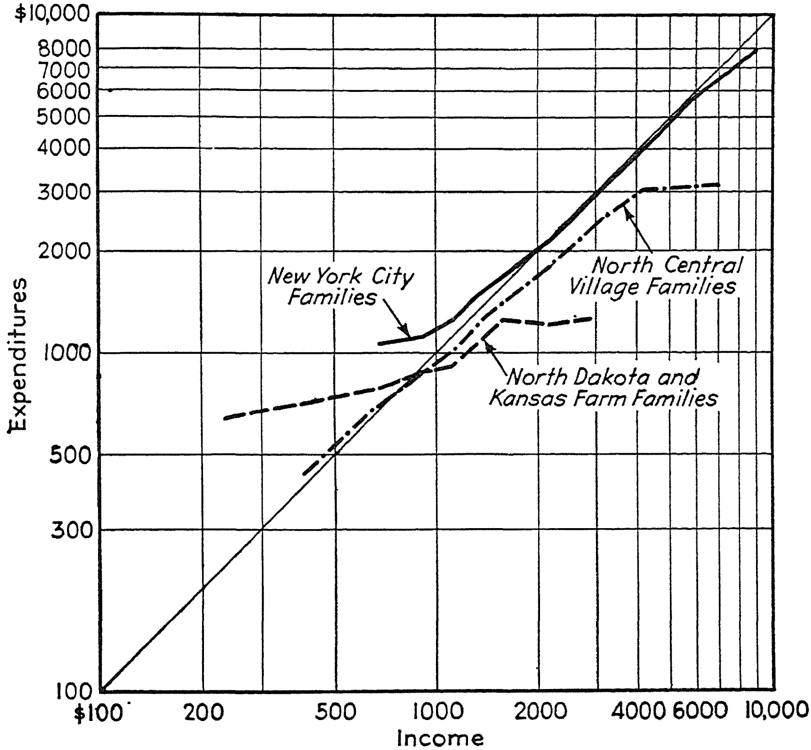

FIG. 1. Savings and deficits of families on various income levels and locations in the United States, 1935–1936. The diagonal line in the diagram indicates where the lines for the various groups would lie if expenditures and income were the same. When the group lines are above the diagonal line expenditures exceed income, and when the group lines are below the diagonal line expenditures are less than income.

largely to the difference in spending opportunities in their localities. In New York City expenditures approximate incomes over a considerable range. The North Dakota and Kansas farmers do not change their expenditures nearly as much as incomes change.

These saving levels and characteristics are important, since the net capital formation of the country appears to be drawn largely from this source. Undistributed corporate profits were negative over the

years from 1919 to 1938; and even over the prosperous decade from 1919 to 1928 constituted little more than a tenth of the average volume of net capital formation. Similarly, government savings, while substantial, were minor as compared with the savings of individuals. The latter amounted to over 95 per cent of net capital formation over the two decades from 1919 to 1938; and almost 70 per cent even in the prosperous decade from 1919 to 1928. The sample data of the Consumers Purchases Study of 1935–1936 indicate that the bulk of the savings by individuals came primarily from the upper income groups. The savings of families and single individuals with incomes of $5,000, and over, who accounted for only one-fortieth of the total income-receiving units, provided almost eight-tenths of the total saving by individuals in those years.

Capital accumulation is proceeding at a more rapid rate under an unequal distribution of incomes than it would be likely to under a more equal distribution. It is, in consequence, often argued that when we adopt a long-range view of society this inequality of incomes secures a more rapid progress than we would have under a more equal distribution of incomes. It must not be overlooked, however, that much of the increase of the income of the poor, if it were at the expense of the larger incomes, though it would not be saved and appear in the form of capital, would nevertheless be invested in a very real sense. Better homes and living conditions might be provided, and more might be spent on education. It is quite possible that these investments might yield even more to social well-being and progress than similar investments in material equipment.

5. Comparisons of Money Incomes. Reasons have already been indicated for the probable failure of estimated money incomes to reflect properly the real income of persons or of the community. Several of the more important differences may again be noted. (1) The real income of society must necessarily exceed the goods and services represented by the money income because of the omitted or uncounted items. Money income estimates reflect only the activities of the 55 million or so of our gainfully employed, and certainly the remainder of the 130 million of our population produce a considerable amount. The services of housewives are an outstanding example of an omitted item. (2) The usual estimates of money income overstate the fluctuations of the real income of society during cyclical changes. Real income does not fall so low in a depression period as money income, even after adjustment for changes in the level of prices is made. People continue to use their durable goods even though they

do not replace them as before. Automobiles, for example, are run longer before being dismantled; houses, clothes, and equipment are repaired and made to last longer. Although the quality of service rendered probably declines, nevertheless these things are made to yield services when under better conditions they would have been discarded for newer articles. Moreover, in these periods people prepare for themselves things they have previously chosen to buy in the market: housewives preserve fruits and vegetables and mend more, and the men make repairs and do small construction jobs. Thus the real volume of goods and services does not decline so much as the decline in money income indicates. (3) Though real incomes are very unequally distributed, the differences are not as great as those indicated by the distribution of money incomes. The lower income groups do for themselves many things for which the rich pay in the market: more household production goes on in the poor households; those on lower incomes save a smaller proportion of their money incomes and are more likely to receive uncounted assistance.

Questions

1. What factors other than income also limit consumption?
2. In a period of falling prices, would the real income of society or its money income decline more?
3. Turn to some standard text in economics and determine the distinction between wealth and income. Now discuss the proposition that all consumption is equally destructive of wealth.
4. Are savings part of the national income?
5. Is the dissatisfaction with our personal income all a matter of relatives, *i.e.*, the greater amount that someone else has?
6. Per capita incomes in 1929 were estimated as nearly three times as large in the Middle Atlantic states as in the East South Central states. What could account for such great differences?
7. With the help of the Bureau of Internal Revenue Office in your community determine the precise effect of Federal income taxes on the net income of (*a*) a man earning $20,000 a year and (*b*) one making $5,000 per year as between 1936 and 1946.

CHAPTER IV

PRICE BEHAVIOR AND THE CONSUMER

It is a familiar fact that the prices of commodities change. When the prices of large numbers of commodities are observed over a period of time, a great many changes will be found to have taken place. When one year is compared with the preceding year, some prices will be found to have risen, some to have fallen, and some to have remained the same. The range covered by these fluctuations may be very large; for example, in 1896 the average wholesale price of potatoes fell 54.6 per cent and the price of coke rose 41.5 per cent as compared with their average wholesale price in 1895. Among these many sorts of price changes, we are able to distinguish two general groups: those which affect only one or two commodities, and those which are widespread and general and influence all commodities. We speak of the latter as a change in the general price level or the purchasing power of money, by which we mean that in general the dollar will purchase more or fewer goods than formerly.

1. The Measurement of General Price Changes. It is difficult, because of the diverse changes in prices, to say whether the dollar will purchase more at one time than at another. It will purchase more of some commodities and less of others. A summary or average of these many changes must be made in order to determine what the change, in general, has been. An index number is the device by which these changes are summarized and expressed. Index numbers may be used to express other changes as well as changes in prices—*e.g.*, changes in the physical volume of production or the volume of business—but their more common use is in connection with prices. The prices to be included in the index depend upon the particular purpose for which the index is prepared. Thus an index of the general price level will require that all prices be represented, or at least the prices of all the more important commodities. Some indexes, on the contrary, will deal only with the prices of a particular group of products; an index of the cost of living, for instance, will include only the prices of the commodities that the consumer purchases. The problems involved in the

construction of index numbers are complex and can be only briefly mentioned here.

Index numbers are of two general types:[1] (1) those in which the prices of individual items have each been reduced to a percentage of the price or size of those items in a year or period, called the *base*, and an average taken to represent the change in the group; and (2) those in which the group of items is represented by an appropriate average or total, and these averages or totals are expressed as relatives of the averages or totals in the base periods. Index numbers of the first type are averages of relatives; those of the second type are ratios of averages, or aggregates.

Let us suppose the problem to be that of measuring the changes of the retail cost of dairy products relative to their cost in 1941, and we have the following data:

Kind of dairy product	Average retail price of dairy products, cents		
	1941	1943	1946
Milk, per quart	13	15	18
Butter, per pound	41	53	71
Cheese, per pound	30	37	50

The year 1941 is taken as the base period. In the first type of index, the average of relatives, we would consider the price of each kind of dairy product in 1941 as representing 100 per cent, express the price in each following year as a percentage of the 1941 price, and take an average of these relatives, thus:

Kind of dairy product	1941	1943	1946
Milk	100	115	138
Butter	100	129	173
Cheese	100	124	167
Total	300	368	478
Average	100	123	159

This index gives equal importance to each commodity included. The expression of prices in relative terms means that the physical units for which the commodities are priced have no influence on the index.

[1] See A. A. Young, in H. L. Rietz's "Handbook of Mathematical Statistics," Chap. XII, Index Numbers.

In the second type of index we would simply sum or average the actual prices and express them as relatives as follows:

Kind of dairy product	Price		
	1941	1943	1946
Milk	13	15	18
Butter	41	53	71
Cheese	30	37	50
Total	84	105	139
Relative	100	125	166

A simple summation of prices is seldom sufficient to constitute a desirable index. If people generally consume five times as much butter as cheese, the decrease of 5 cents in the price of butter in our illustration would have had five times the significance of the 5-cent decrease in the price of cheese. Commodities, in consequence, are usually "weighted," or multiplied by some number that indicates their relative significance for the particular purpose for which the index is being prepared. The result is a *weighted* index number, and the effect of weighting is an index number which indicates proportional changes. When the prices are not weighted, the index is called a *simple*, or *unweighted* index. Indexes using actual prices will be weighted by quantities, and indexes constructed from relatives will use relative expenditures as weights. The significance of an actual price change depends upon the quantity of the product affected by that change, whereas the importance of a relative change in price depends upon the relative expenditure upon that commodity. Indexes constructed on this basis are shown below:

Kind of dairy product	Weighted average of relatives				Ratio of weighted aggregates			
	Weights	1941	1943	1946	Weights	1941	1943	1946
Milk	58	5,800	6,670	8,034	25	3.25	3.75	4.50
Butter	37	3,700	4,773	6,401	5	2.05	2.65	3.55
Cheese	5	500	620	835	1	.30	.37	.50
Total	100	10,000	12,063	15,270	31	5.60	6.77	8.55
Index	...	100	121	153	...	100	121	153

It will be noted that in this case the two indexes are the same. This is because the weights used in the weighted average of relatives represent the proportions of the expenditures on the commodities in

1941 when purchased in the amounts used as weights in the index of aggregates. The ratio of weighted aggregates has the advantage of being a readily understandable type of index, a given bill of goods is priced at different periods and their total cost compared. It is, in consequence, a widely used type of index. The weighted average of relatives may, however, have advantages when certain prices fluctuate similarly to other prices and a single price may be taken as representative of a group. In these cases it is unnecessary to have all prices available for computing the index if the proper weights are available. This is useful when a large number of items are involved in the index and the resulting computations are laborious.

Where index numbers are prepared for special purposes, such as to show changes in the cost of living, they are nearly always weighted. It has sometimes been argued that where index numbers of prices in general are constructed by an average of relative prices weighting may be dispensed with. The unweighted index number, however, is sensitive to abnormal variations of unimportant prices and is too little influenced by large variations of important prices. Usually, therefore, index numbers are more accurate when weighted.

An additional opportunity for variation in index numbers arises because of the different averages that may be used to summarize the data. The most common is the arithmetic mean, or ordinary average, derived by dividing the sum of the individual items by the number of items or by the sum of the weights in the weighted index. The other average that is frequently used is the geometric mean, where all the prices or ratios for a given date are multiplied together and the nth root extracted, n standing for the number of commodities included. The geometric mean for 1943 for our unweighted average of relatives would be $\sqrt[3]{115 \times 129 \times 124} = 122.5$. The geometric mean is widely used for averaging price ratios, since equal weight is given to equal ratios of change. This is equivalent to saying that equal weight is given to a price that doubles and a price that falls one-half.[1] Medians, modes, and harmonic means are occasionally used in preparing index numbers. The figures may also be left as an aggregate instead of striking an average.

The most widely used index of the general price level in the United States is the Wholesale Price Index of the U.S. Bureau of Labor Statistics. The recently revised number is a weighted aggregate index of 784 quotations of wholesale prices. Each quotation is weighted by an estimate of the annual amount marketed during the years from

[1] See C. M. Walsh, "The Problem of Estimation," for a classic presentation of the arguments in favor of the geometric mean.

1923 to 1925. The sum of these items for each period is expressed as a relative of the sum in 1926. Subtotals are found for nine commodity groups, and these also are expressed as indexes. The Federal Reserve Board publishes index numbers compiled from prices collected by the Bureau of Labor Statistics, using the Bureau's methods but grouping the data into separate indexes of raw materials, producers' goods, and consumers' goods. A large number of indexes are prepared by various private agencies—*e.g.*, those published by Dun & Bradstreet, Fisher, the Harvard Bureau of Economic Research, *The Annalist*, Snyder, and numerous others.

Index numbers have many uses. The conditions of economic life are complex, and we need summary expressions to indicate clearly exactly what has happened. Index numbers are utilized for that purpose in various sections of this book. For example, when it is desired to show the growth of advertising in the United States, to picture *changes* in real wages over a period of time, or to indicate the degree of change in national income during the depression, the device is utilized.

2. Types of Price Movements. When the general level of prices is observed for a considerable period of time, three distinct types of price movements appear. Some of these can be distinguished in Figs. 2 and 3.

(1) There are periods when prices rise violently and then break.

Fig. 2. Change in the general price level, 1860 to 1945.

Such rises occurred, as may be seen on the preceding chart, during the period of the First World War, from 1914 to 1921, and the Civil War period, from 1860 to 1870. These violent movements of prices might be called *periods of inflation and deflation.* (2) There are certain sustained general movements of the price level, continuing over a period of time. For example, from 1873 to 1896 the general trend of prices was downward, and from 1896 to 1914 the trend was upward. These general movements of prices are spoken of as *secular trends.* (3) There are wavelike movements of prices above and below the secular trend which last from 3 or 4 to 10 or 12 years. These are called *cyclical movements* and are related to and correspond closely with the so-called *business cycle.* Each of them has an effect upon consumer welfare.[1]

The secular changes in the price level are explained by the economist principally by the quantity theory of money. The price level is thought to depend upon the relation between the amount of money and credit, its velocity of circulation, and the quantity of commodities that are bought and sold. The greater the quantity of money (in the broad sense) relative to a given quantity of goods, the higher the price level is likely to be. If the quantity of goods increases more rapidly during a given period than the quantity of money, other things remaining equal, prices may be expected to fall. If the opposite condition obtains, a rise in prices can be expected.

Wars almost invariably bring about some inflation. This is due in general to an altered relationship between available goods and services and expendable dollars in the hands of consumers. Consumer incomes rise, not only because of increases in wage rates (instituted in part to draw people into essential industries), but because of upgrading and working longer hours. Shortages of consumers' goods develop because the production system is shifted in considerable part to the task of manufacturing the instruments of war. The demand for almost all types of goods is exceedingly heavy, because the new war demands are added to those of consumers. Costs rise, due partly to increased wages, but more importantly perhaps to declining efficiencies as greater proportions of inexperienced and inept individuals are

[1] Another important type of price movement is the *seasonal.* This type is not a *general* movement but occurs in certain kinds of commodities only and at different times for different goods. Seasonal movements are very important to consumers, however, since purchasing savings accrue to those who properly time their buying. Hence some space is devoted to this subject in Chap. XVIII, The Problem of Purchasing.

drawn into industry. Finally, speculation with its tendency to bid up prices develops in such times because prices are rising and expected to go higher.

The period of the Second World War provides an excellent opportunity of observing the factors underlying the general level of consumer prices. The basic data are shown in Table 9.

TABLE 9. CONSUMER MONEY INCOMES AND THEIR UTILIZATION IN THE UNITED STATES, 1939–1946*
(Billions of dollars)

	1939	1940	1941	1942	1943	1944	1945	1946	1947
Income payments to individuals..........	72.6	78.3	95.3	122.2	149.4	164.9	171.6	178.1	195.2
Personal taxes and nontax payments........	2.4	2.6	3.3	6.0	17.3	18.9	20.9	18.9	21.6
Disposable income.....	70.2	75.7	92.0	116.2	131.6	146.0	150.7	159.2	173.6
Consumer expenditures.	67.5	72.1	82.3	90.8	101.6	110.4	121.7	147.4	164.8
Net savings of individuals..........	2.7	3.7	9.8	25.4	30.0	35.6	29.0	11.8	8.8
Cost of living (1935–1939 = 100)...	99	100	105	117	124	126	128	139	159

* *Federal Reserve Bulletin*, October, 1948.

Income payments to individuals represent the wages, rents, royalties, interest, and entrepreneurial earnings received by people in the United States. From these total monetary receipts are deducted the personal taxes and nontax payments which people were required to pay. Laws make these mandatory and not subject to the decisions of individuals. The remainder is disposable income, or the income which people were free to dispose of or spend as they wished. The income could be spent or saved as the individual desired. The amount of estimated expenditures on goods and services is shown in line 4. These estimated expenditures are the product of the physical quantities of goods and services times their prevailing prices. The difference between disposable income and consumer expenditures constitutes savings. The savings in 1939 and 1940 may be considered as usual. Consumers do not customarily spend all their income but save at least some portion in normal times. Beginning in 1941 income payments to individuals rose considerably, while the production of consumers' goods leveled off and there was in consequence an increase in the cost of living. The annual figures do not disclose the full

extent of the rise, since most of it occurred during the latter part of the year. Early in 1942 price controls were inaugurated. The figure for net savings now includes in addition to the usual savings additional funds that consumers probably would have spent if they could have found goods which they wished to buy. This range of willingness to increase expenditure, or upward pressure on prices, due to scarcity of goods has been called the "inflationary gap." Unrestrained, the consumers would have sought out and bid for the available goods until their prices rose sufficiently so that consumers' expenditures and disposable incomes were again in balance with a more normal level of savings.

The basic problem of wartime price controls now becomes clear. It was to lessen the inflationary gap, or to reduce its power to raise prices, by government borrowing of these free funds from consumers. In order to hold down the size of the inflationary gap with a given level of consumer expenditures it is necessary to keep disposable income from rising. This can be accomplished by preventing a rise in the income payments to individuals or by increasing taxes. After the war was well under way the first of these steps was undertaken by fixing wage levels and limiting the shifting of jobs by individuals. Taxes were also increased, but far less than recommended by most economists. These procedures were too late and too limited to prevent the occurrence of a considerable inflationary gap. The influence of the gap on prices was lessened by governmental borrowings of these funds from individuals through the sale of bonds. The bond purchaser turned over to the government his current purchasing power and received in exchange a promise of later repayment in dollars.

The secondary attack on the tendency for prices to rise was to establish price ceilings and to ration goods. Price ceilings by themselves cannot be expected to control prices for any length of time.[1] If consumers have excess funds after they have purchased all the goods in the market available at prevailing prices, then they will seek to expend these funds for goods which they want unless restrained by

[1] It should be clearly understood that there is nothing magical in ceilings; they are easily evaded, with the result that black markets are created. Indeed, at times an article of merchandise is not to be had except through the black market. At times, also, there are very serious consequences of black market operations. Such was the case in the meat industry late in the war, when a critical shortage of glandular products developed because of the large portion of meat slaughtering done by black market operators who did not bother to save glands.

fear of drastic police action or prevented from violation by patriotic motives.[1] Ceilings are, however, useful in retarding and slowing down the price rise. With consumers able to buy more goods than are available on the market at the ceiling prices, some system other than price is essential to ration or allocate the goods among consumers. If supplies are fairly large, so that price ceilings are near what prices otherwise would have been, then informal rationing by merchants works fairly well. But if ceilings are well below what prices otherwise would have been, then formal governmental rationing (which has the effect of temporarily placing limitations on the use of money in purchasing commodities) such as we had during the war for many commodities is essential.

Returning to Table 9, one observes that the combination of controls during the Second World War was surprisingly successful although some of the real rise was hidden in the form of subsidies. The rise in the cost of living was much less than in the First World War. The rise was likewise less than in nearly every other country of the world. In many places inflation has been of gigantic proportions. The inflationary gap in this country was largely absorbed by savings of individuals. When controls were removed in June, 1946, a very rapid and continued rise in prices occurred. Consumer expenditures increased relative to disposable income because of larger quantities of goods, but much more because of the price increase. Ultimately, of course, a balance must be reached between the two.

3. Effect of Changes in the General Price Level on Various Classes. Changes in the general price level are of great significance in the economic life of the people. Any change of considerable magnitude shifts purchasing power among groups, resulting in benefits to

[1] Price control by fiat, because of the element of patriotism, works best in wartime. Even under these most favorable circumstances, however, price fixing by mere government order cannot be expected to work long. In the first place, violations of ceiling prices—what are known as black, or at least gray, markets—begin to develop. Second, certain goods simply disappear from the market, with the result that ceiling prices prevail, but on nonexistent goods. Third, ceiling adjustments are ultimately demanded by vendors, many of which, must be granted if goods are to be forthcoming; hence a break-through begins which makes for more and more difficulty in holding the line. Apropos of this last point, "It is reported that before the temporary demise of OPA at the end of June [1946], it had granted to individual companies in the first quarter of this year some 4,318 price increases, and 9,425 more in the second quarter, or a total of 13,743. These authorized price increases were so inclusive that in the first half they covered in their provisions nearly 600 separate industries on a country-wide basis." Cleveland Trust Company *Business Bulletin*, Aug. 15, 1946.

some and hardships to others. This is because all prices do not change with equal rapidity or to the same extent. A considerable group of prices, such as those of annuities, interest payments, and public-utility rates, change very slowly, and the groups concerned with such transactions are influenced particularly.

The most marked changes take place in the relationship of debtor and creditor. The debtor gains on rising prices.[1] His obligations may now be paid with the equivalent of a smaller quantity of goods than before. Thus if wheat is 50 cents a bushel, it would require 2,000 bushels of wheat for a farmer to pay a debt of $1,000, whereas if wheat were $1 a bushel the debt could be retired for the equivalent of 1,000 bushels. During a period of falling prices, creditors gain. The amounts borrowers must repay will now purchase more than at the time the loan was made. Those who are on fixed incomes are in the same situation as the creditor class; in fact, most of those who have fixed incomes secure them by loaning money to others or by the purchase of bonds or annuities, which is an analogous operation. There are, moreover, many salaried people who for considerable periods of time are essentially in a similar situation. Debtors naturally prefer prices to rise, whereas creditors and those with permanent posts at fixed salaries favor falling prices. University professors as a class, for example, are in an excellent position when price levels are at a low point. This is due not only to the fact that their fixed dollars buy more things but that usually they continue in their positions throughout the period during which low prices prevail.

Business generally gains when prices rise. The businessman is usually in a debtor position, and many of the payments he must make for such items as rents, salaries, and interest do not rise so rapidly as the prices of goods that he has for sale. Profit margins tend to widen, and business activity is stimulated. If we include the farmer in this group, we find him affected most of all because of his generally important debtor situation and because of a tendency of agricultural prices to rise faster and fall faster than industrial prices. The opposite situation prevails when prices fall, and generally losses are incurred in the agricultural field.

[1] It is possible, in extreme circumstances, for a price rise to wipe out the holdings of creditors. The price rise in Germany in the 10 years following 1913 was so great, for example, that, by 1923, 4 million paper marks had a purchasing power of 6 prewar marks. A creditor with an equivalent of 1 million dollars of securities actually could have been repaid by his debtors with currency having purchasing power sufficient to buy only a moderate-priced dinner for two.

The situation of wage earners is somewhat more complex. As was suggested above, the employed worker gains on falling prices and loses on rising prices because his wages usually lag; this assumes of course that the impairment of personal advancement during periods of business inactivity does not offset such gains. But because of the changes in business activity, which are usually associated with price movements, employment generally increases with rising prices and declines with falling prices. Thus, while wage rates lag, the number employed increases on the upswing and the laboring group gains in total purchasing power, whereas the reverse occurs when prices are falling. The gain from reemployment would be largest in the early stages of the price increase and the losses from the wage lag greater for the group in the later stages. One result of moderate inflation not usually recognized is that of altered spending habits among "beneficiaries" who later find it difficult to return to a sounder pattern.

There is one other major factor which must be taken into account in considering the impact of price changes on consumers, and that is the *extent* of the price change. On the one hand, prices may decline not moderately, but so drastically that no one will be secure, not even those on a so-called fixed-salary basis and those to whom money is owed (creditors). Under such circumstances the former might have his salary materially reduced or terminated, while the latter might be unable to collect the relatively high rate of interest which debtors had contracted to pay and might even be faced with the loss of the principal sum. On the other hand, prices may move up not moderately but violently.[1] Under such conditions of *hyperinflation*, so called, the normal analysis of impact, discussed earlier, may not be applicable. It is very likely that, as in the case of drastic price *declines*, very few are advantaged by a violent *rise* in the price level. Wage earners probably suffer under such conditions, regardless of the jobs they hold, because of a constant lag of wages behind skyrocketing prices;

[1] Such is the situation in postwar China. According to the League of Nations' *Monthly Bulletin of Statistics* for June, 1946, the index of the cost of living in that country was 67,910 in Sept. 1945 (1939 as a base, 100). Conditions in Hungary, to take another example, are similar, perhaps even worse. According to *Life* (July 8, 1946), "By last week inflation had reached such terrifying proportions in Hungary that people were letting pengo notes of high denominations fall into gutters . . . and street cleaners were . . . sweeping up the paper money like rubbish. Hungary's inflation is 100 times dizzier than Germany's after the last war. A cigarette costs a million pengos, or $200,000 at prewar rates of exchange. Wage earners need suitcases to cart away their weekly pay. Last week, as a new 100-trillion pengo note (worth 20c) was issued, the government finally got around to price control and rationing. Prices are set at 6 A.M. daily, may not be raised during the rest of the day."

businessmen are likely to suffer also because of a tendency toward constantly declining inventories.[1] Those living on farms where food and shelter are provided are probably most favorably situated during a period of runaway inflation, as was evident in postwar Europe.

A movement of prices therefore affects each group in the community and changes its position relative to other groups.[2] It is not surprising, then, that even moderate changes in the general price level are associated with unrest in particular groups and sometimes with class disturbances. There is usually labor unrest when prices are rising. City people are dissatisfied, and there is much talk about the high cost of living. There is agricultural unrest when prices are falling and much talk about the unjust debt situation. The period from 1870 to 1896 was one of downward trend in prices. Farmers organized the Greenback party and put candidates into the field for president and Congress from 1876 to 1884. Silver had been demonetized in 1873, and this was assumed to be one of the causes of the lower prices. Farmers referred to the "Crime of 1873" and pressed first for silver-purchase laws and later for free coinage of silver at 16 to 1. The drive culminated in 1896 in the presidential campaign of W. J. Bryan and his famous cross-of-gold speech. From 1896 to 1920, prices rose and labor strengthened its unions. The American Federation of Labor had less than half a million members in 1897, but by 1920 over 5 million. Toward the close of the period and during the war there was great complaint about the high cost of living. From 1920 to 1933 there was again great agricultural unrest, which gradually subsided in the rise from 1933 to 1937. The latter period was again a time of labor unrest. The year following the end of the Second World War was characterized by demands of labor for higher wages to offset higher prices. This tends, of course, to develop into a spiral.

[1] Because of the lag in payments for goods sold, receipts will purchase decreasing amounts of raw materials or merchandise for resale when prices start running away.

[2] From the point of view of the individual the problem is often even more complex than it first appears, since some consumers find themselves in the position of being at once creditors (investors in securities, for example), debtors (mortgaged property owners, say), and wage earners. Individuals of this type might be adversely affected by price declines, say, in their capacities as debtors and—under some conditions—wage earners, and favorably affected in their capacities as creditors. Conversely, for some consumers price increases may improve their position in one of their several roles, yet adversely affect their position in one or more of several others.

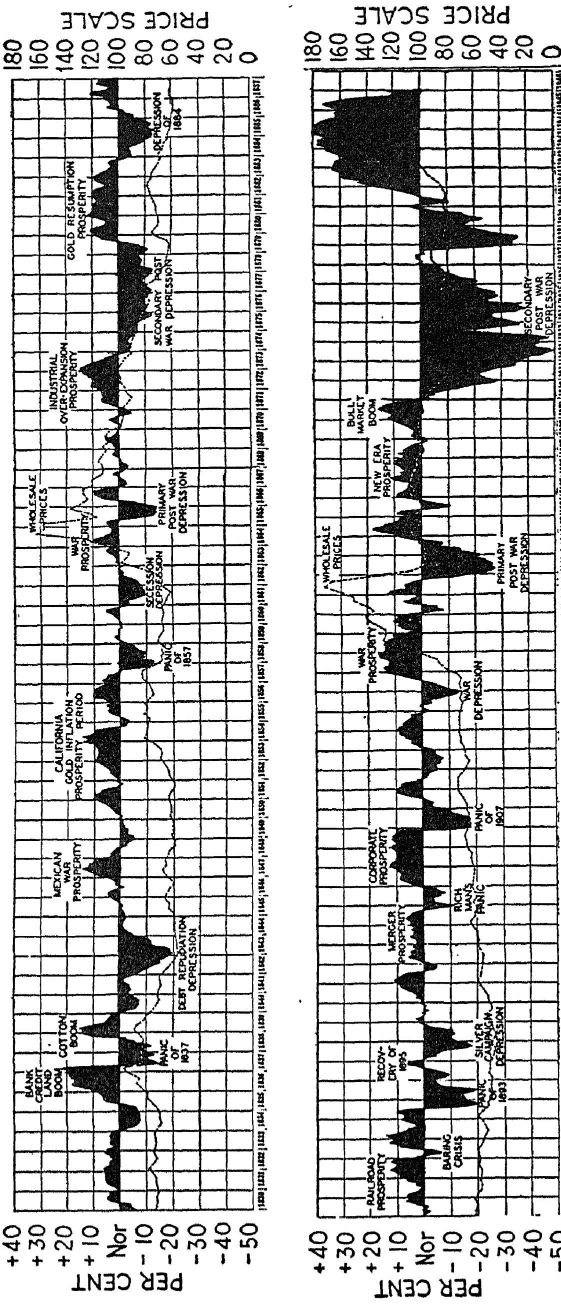

FIG. 3. Fluctuations in business activity in the United States, 1830 to 1946. (*Reproduced with permission of the Cleveland Trust Co.*)

4. The Business Cycle and the Consumer. The cyclical changes in the general level of prices above and below the secular trend are, in a large measure, due to the variations in business called the *business cycle.* In these fluctuations there are periods of considerable expansion and contraction of credit by banks. During a portion of the cycle, bank credit expands the means of payment for goods more rapidly than goods are increasing, and here we find rising prices, while in another phase we find the greater contraction of credit and falling prices. There are many other factors, such as general business psychology, which influence these short-time movements, but bank credit probably plays a dominant part.

Cyclical fluctuations in business activity are indicated by changes in the general price level about as well as by any other single index. The business cycle, however, consists of a great deal more than simply a change in the general price level. There are changes in employment, rates of wages, volume of production, profits, interest rates, volume of credit, and other important relationships. Consumers will be variously affected by the cycle and in different portions of it. This is because the term *consumers* includes everyone, and different groups are affected differently by the cycle and its stages. As has been suggested, incomes and the prices of the products that are purchased with those incomes do not change simultaneously, and in consequence real incomes vary.

These fluctuations in business activity follow one another in a fairly definite succession. The cycle is generally divided into four stages: periods of depression, of recovery, of prosperity, and of liquidation. There is no constant length for the entire cycle nor for any of the stages of the cycle. Each cycle is distinct in itself and differs from other cycles in important details. There is no sharp break between the different stages of the cycle—they pass gradually from one to the other. The stages, however, differ somewhat in their lengths; the period of recovery, for example, is generally the longest, that of liquidation the shortest.

The relations between the production of goods, their consumption, the accumulation of stocks of goods, and the prices of goods vary during the cycle. If we begin with the period of depression, we find that it is characterized by small production, low prices, and low profits. There is a great deal of unemployment. The volume of physical production in some industries frequently falls to as low as 50 or 60 per cent of the average production. There are large stocks of goods accumulated from earlier phases of the cycle. These consist of con-

sumers' goods, partially processed goods, and raw materials. Consumption is low, relative to other periods, but is greater than current production. The real income of society is low for nearly all classes. Since current production is less than current consumption, the existing stocks of goods must be cut down; after they have been exhausted, goods must be produced at an increased rate if the current rate of consumption is to be maintained. The increase in production is not immediately accompanied by a rise in prices, since many of the plants have been operating at only a part of their capacity and may actually lower their unit costs as they expand operations. Sooner or later, however, additions to plants and repairs become necessary, and the industries making producers' goods increase their activity. Prices now begin to rise, and the cycle has passed into the so-called *recovery stage.*

The increase of employment that begins during the period of depression and extends through the period of recovery and well into that of prosperity brings an increasing real income to labor as a class. The increase in the rates of wages comes somewhat after the increase in prices has begun, and the rate of increase continues to lag behind that of prices. The laborer who has been previously employed thus suffers a decrease in real income, since the prices of the goods that he is purchasing are rising more rapidly than his wages. The amount paid laborers as a total, however, is increasing, and increasing even more rapidly than prices, because of the greater employment of labor, and in consequence the real income of labor as a whole is increasing. Profits are also increasing, since wages, rents, and capital costs are lagging behind prices. This means that the real income of the employing class will be increasing.

The rising prices stimulate the production of consumers' goods and greatly intensify the activity in the production of producers' goods as well. Dealers, manufacturers, and even consumers begin to expect the increase of prices to continue and begin to accumulate stocks. This continues through the period of prosperity. For this to take place, the production of goods must exceed current consumption. Prices now rise rapidly. The period of recovery passes into that of prosperity. During the early phase of this period the real wages of labor are high, both because more are employed and because the rates of wages begin to creep up to the level of prices. Men may also move into higher grades of employment. It is quite common during periods of prosperity, when labor is scarce, for laborers to advance beyond their accustomed class. Thus, an unskilled laborer may secure a job as a skilled laborer. The income of the employing class

probably begins to decrease during the period. Certain producers begin to recognize that their lines are overcrowded and lessen their activities toward expansion. This affects materially the demand for production equipment and the buying power of the laborers in these industries.

There is now a rapid passage into the period of liquidation. Dealers try to work their stocks off and cease buying. Industries shut down as far as possible. Employment decreases very rapidly. The rates of wages fall, but not so rapidly as prices, so that the real wages of those who remain employed are higher. The great increase of unemployment and part-time work, however, lowers the real income of the laboring class a great deal. Workers also change from higher to lower grades of work, which lowers real income even though the rates of pay for each type of work remain the same. Heavy losses are sustained by many businessmen, and the incomes of this class are seriously curtailed. The period of depression has arrived, which is presently turned into a period of increasing activity in the manner that has been indicated.

A chart showing fluctuations in business activity from 1830 to 1946 is given in Fig. 3. From this, fluctuations in business conditions are clearly discernible. In addition to declines in business activity, which seem to visit our economic system in a more or less regular fashion, there are the industrial declines following major wars. These should be of particular interest at this time. On a basis of past experience, each major war in which we have been engaged seems to have been followed by a primary and then by a secondary postwar depression. When one examines the course of American business activity on such a chart since 1830, one sees that this situation seems to have prevailed first following the War of 1812. The primary postwar depression of 2½ years' length extended from the middle of 1812 until late 1814, a second depression coming five years later and extending from the middle of 1818 to late 1821. This dual postwar depression situation reappeared following the Civil War. As may be seen by the chart, the primary slump following that war began almost immediately after the cessation of hostilities and extended for only one year, from early 1865 to early 1866. In this instance the secondary period of business depression did not start until eight years later; this second period of business inactivity lasted for six years.

The First World War was followed by a similar double pattern of depression of business activity. As may be seen from the chart, the primary postwar depression was precipitate but relatively short, beginning in early 1920 and extending to the middle of 1922. Then

came seven years of what appeared to be prosperous conditions, followed by the worst depression the modern world has ever known. This latter period began in late 1929 and continued through seven black years; then, just as the business wheels started rolling again, industrial activity declined once more, and this *recession* (so called) continued for almost three years until preparations for our latest conflict got under way. One can only guess whether history will repeat itself following the Second World War.[1]

5. Consumption and the Business Cycle. As is evident from the foregoing discussion, consumption is profoundly influenced by the business cycle. Production of certain commodities declines greatly, the usual demand and supply relationships are disrupted, and incomes shift materially, with the result that there is a considerable shift in consumption patterns.

The great decline in real income in the community as a whole in a depression is well indicated by Table 1 in the preceding chapter which shows income payments to individuals. As was pointed out, however, real income could not have fallen so low, for the consumer received services from durable goods in his possession, such as houses, automobiles, and household equipment. The services provided by these goods in the latter part of the depression were not so efficient as in the early part because of obsolescence and depreciation, but were nevertheless of considerable magnitude. Likewise, as has been previously noted, the household at such times provides services of its own which formerly it purchased in the market.

Another very important phase of the effect of a depression on consumption is manifested in a decline in individual money incomes. Table 10 shows the nature of these shifts between 1929 and 1933 for a group of Minneapolis families. From these data it can readily be seen that those who are in the lower income groups in good times tend

[1] Wars create terrific maladjustments in the economic system which require many years for readjustment. Trade relations with various countries are disrupted, with the result that new sources of supply are developed; industries get a start (because of temporarily inflated price conditions) which often cannot stand on their own feet in the postwar period. People, too, are drawn from peacetime to wartime activities and later must return to some peacetime pursuit. At the same time, war is destructive, not constructive—as a result there is a loss of man power due to death, injury, and interrupted training; moreover, tax burdens are created which are very difficult to carry. Speculation develops out of uncertainties and many errors are made both by individuals and by the government. In short, transition from war to peace is likely to be exceedingly painful; indeed, it is doubtful whether the effects of a great war are ever entirely overcome.

TABLE 10. INCOMES OF 16,737 IDENTICAL MINNEAPOLIS FAMILIES IN 1933 COMPARED WITH 1929*

1929 income	Were in a lower income class in 1933	Were in same income class in 1933	Were in a higher income class in 1933	Average income of class in 1929	Average income of same families in 1933
No income	....	177	119	....	$288
Under $250	14	178	86	$160	356
$250–$499	157	338	150	396	441
500–749	417	361	111	618	546
750–999	899	397	247	894	713
1,000–1,499	2,120	1,262	291	1,252	905
1,500–1,999	2,321	975	181	1,737	1,212
2,000–2,999	2,363	1,090	123	2,404	1,649
3,000–4,499	1,070	364	18	3,521	2,260
4,500–7,499	461	179	13	5,386	3,478
7,500 and over	175	80	....	12,822	6,111
All classes	9,997	5,401	1,339	$1,993	$1,350

* Adapted from HORST MENDERSHAUSEN, "Changes in Income Distribution during the Great Depression," National Bureau of Economic Research, p. 148.

to retain the status quo when depression sets in, while those in the higher brackets find it very difficult to maintain their positions. Data for 32 other cities show similar characteristics. The depression lessened the differences between incomes as measured in dollars, but the relative inequality of incomes increased. The proportion of the total income received by the upper half of the recipients increased, while the proportion of the total income received by the lower half decreased. These conclusions have been substantiated by studies of the distribution of family incomes during the period of rising incomes of the war.[1] During these periods the majority of incomes seem to have increased, but with the incomes of the lower income groups increasing relatively more. The result was a lessening in the relative inequality of incomes. The proportion of the total income received by the upper half of the recipients declined, while that received by the lower half increased. Thus depressions tend to increase and prosperity to decrease the proportion of the total income going to the upper half of the income receivers.

The effect of depression and recovery upon individual items may be examined by noting the changes in consumer expenditures on the

[1] See "Spending and Saving of the Nation's Families in Wartime," *U.S. Bur. Labor Statistics Bull.* 723.

items and also on the physical volume of sales. The former give an indication of the rearrangement by consumers of their expenditures, and the latter, of the physical changes in consumption. Tables 11 and 12 bring together data on these phases.

TABLE 11. PERSONAL CONSUMPTION EXPENDITURES IN THE UNITED STATES IN SELECTED YEARS*
(Billions of current dollars)

Item	1929	1933	1937	1941	1946
Food and tobacco	21.4	12.8	21.6	26.5	55.1
Clothing and accessories	11.0	5.4	8.0	10.5	22.2
Personal care	1.1	0.7	1.0	1.2	2.3
Housing	11.4	7.8	8.4	9.9	12.7
Household operation	10.5	6.4	9.3	11.7	18.0
Medical care	3.6	2.4	3.2	4.0	6.4
Personal business	5.2	3.1	3.9	4.1	5.2
Transportation	7.5	3.9	6.4	8.2	10.9
Recreation	4.3	2.2	3.4	4.2	7.9
Private education	0.7	0.5	0.6	0.7	1.0
Religious and welfare	1.2	0.9	0.9	1.0	1.5
Foreign travel and remittances	0.8	0.4	0.5	0.3	0.4
Total	78.7	46.3	67.1	82.3	143.7
Durable commodities	9.4	3.5	7.0	9.8	14.9
Nondurable commodities	37.7	22.2	35.2	44.0	87.0
Services	31.6	20.6	24.9	28.5	41.7

* "National Income," supplement to *Survey of Current Business*, June, 1947, pp. 41–44.

Great variations in dollar expenditures are evident for the period as a whole. The variation in expenditures on durable commodities is especially marked. Comparing 1946 with 1929 we find the proportion of the expenditures on food much higher. The proportion spent on clothing was also somewhat larger, with the intervening years lower. Housing was at its lowest level in terms of proportions in 1946, probably because of the continuation of rent ceilings, and required the largest proportion of expenditure in 1933, the depression year. Household operation has its largest proportion in 1941, marking the end of several years of heavy buying of durable consumer goods. The proportion of income spent on transportation declined in the depression, was at its peak in 1941, and at its low in 1946. This latter was no doubt due to the shortage of automobiles.

As will be noted, the commodities included in Table 12 represent two different kinds of consumer goods. These are known as *perishable* and *durable* consumption goods. The behavior of the two types

TABLE 12. INDEXES OF PHYSICAL QUANTITIES OF APPARENT CONSUMPTION OF CERTAIN GOODS IN THE UNITED STATES IN SELECTED YEARS*

Item	1929	1933	1937	1941	1946
Electricity (nonindividual)	100.0	119.2	177.2	251.8	386.3
Gasoline	100.0	104.2	198.8	252.2	283.2
Cigarettes (tax withdrawals)	100.0	93.9	136.6	173.4	270.1
Meat	100.0	102.3	95.5	112.5	116.4
Wheat flour	100.0	92.1	90.7	90.0	86.3
Butter	100.0	102.1	94.2	91.4	59.2
Milk	100.0	97.9	96.1	98.2	119.3
Vacuum cleaners	100.0	43.7	102.6	138.4	....
Passenger automobiles	100.0	38.5	88.7	96.2	46.8
Visitors to national parks	100.0	82.6	175.7	210.5	229.3
Departures from the United States	100.0	59.0	90.4	38.0	74.8
Clothing, men's*	100.0	79.0	97.0	138.0	147.0
Clothing, women's*	100.0	91.0	125.0	169.0	197.0
Knit hosiery*	100.0	92.0	115.0	137.0	141.0

* Combination of the index of Solomon Fabricant ("Output of Manufacturing Industries, 1899–1937," National Bureau of Economic Research, 1940) and the Bureau of Foreign and Domestic Commerce Index (*Survey of Current Business*, June, 1947).

in a depression is usually at variance. Some interesting contrasts are shown by the data:

1. Total consumption of certain types of goods changed very little from prosperity to depression, as evidenced by the figures for meat, wheat flour, fruits and vegetables, and milk. These agricultural products are perishable or costly to store, and in consequence must be used as produced. Agricultural production continues in nearly full force during a depression.

2. The consumption of cigarettes (another perishable commodity) declined less drastically than most products. This is a type of goods for which the individual unit of purchase is small and habits firmly established.

3. Sales of durable consumption goods, on the other hand, suffered serious declines, as evidenced by the figures for electrical appliances and automobiles.

4. The *use* of automobiles does not seem to have declined in the depression, however, as is indicated by the physical volume of gasoline

sold. Thus, although new cars could not be purchased, the relatively small immediate outlay permitted the utilization of the old ones.

5. The domestic use of electricity increased materially in the face of declines in the sales of appliances, indicating that the *use* of appliances remained at the predepression levels following 1929.

6. In recreation the consumer tended to (*a*) confine his traveling to America and (*b*) reduce the frequency of his visits to the motion-picture theater. Although figures are lacking, unquestionably there were increases in the patronage of libraries and in the size of radio audiences in the depression.

Questions

1. If the general price level should rise by 50 per cent during the next two years, as some expect, how would you be affected? Are all consumers affected uniformly?

2. Which fluctuates more, the production of goods or their consumption?

3. Study the Cleveland Trust Company chart carefully, and draw conclusions concerning (*a*) the length of depressions, (*b*) how often they occur, (*c*) the causes of some of the major ones, and (*d*) the behavior of prices in relation to cyclical fluctuations.

4. Specifically how is consumption affected in time of depression?

5. Discuss for or against the proposition that hedging against inflation is practically impossible because, for it to be effective, one must not only be sure, say, that a rise in price will eventuate, but must know whether the rise will be moderate or drastic.

6. Discuss the proposition that the effect of inflation upon consumers depends not only upon the situation of the individual consumer and the height of the inflationary movement but also upon the nature of postinflationary monetary adjustments.

7. "Despite the fact that we have in our hands $175,000,000,000 in 'savings,' we didn't save in any real sense during the war. We just created a condition which incessantly calls for saving in the years immediately ahead. And unless we have joined Alice in Wonderland, it means we must produce more and consume less so that we can replace the wealth we have destroyed and make good the losses of the war." Indicate your agreement or disagreement with the foregoing statement and the reason or reasons therefor.

8. Some prices change greatly, some little, and some indeed not at all, in a so-called inflationary situation such as has been experienced during and following World War II. With the help of comparative advertisements found in the newspaper files of your college library or suggestions made by local merchants write a brief report on this phenomenon, bringing out as many examples as possible of each type of price behavior and attempting an explanation in each case.

9. It has been said that rental control in effect is a method of redistributing income. Explain. Would this be true of all price fixing?

CHAPTER V

THE COST OF LIVING AND ITS EFFECT UPON REAL INCOME

The changes that take place in the prices of commodities cause changes in the cost of living of the consumer. The term *cost of living* is, however, somewhat ambiguous. The cost may refer to the money expenses of living, which is the sense in which the term will be employed here, except where specific exceptions are made, or it may refer to the effort or real cost involved in procuring the means of living. Thus, if the prices of products purchased by the consumer remained the same and his wages for the same effort were increased, we would say that the real cost of living had fallen, for he could now procure the same things for less effort. There can be no such thing as *the* cost of living, meaning a single general cost of living. There are many different manners of living and each of these will have a different cost. We do not gain much of an idea of these costs simply by comparing the expenditures and incomes of people, since all we find then is that those with large incomes have large expenditures and, hence, high cost of living. It is necessary, in consequence, to set up some outside measure of living, not related to income or prices, for determining what the costs of living are. There will be many of these costs of living, since there will be many different ways of living.

1. Measurement of the Cost of Living. A usual way of measuring costs of living is to set up a certain quantity of goods, which reflect a particular way of living, or constitute the measurable items of a certain way of living, and price these goods. For example, the U.S. Bureau of Labor Statistics in 1922 determined a minimum standard-quantity budget which in its judgment represented the quantities of goods needed to maintain a family of five at the minimum level of health and decency. This budget was priced in many places and used to determine the cost of living at a minimum standard. Most studies of this sort have been of costs at a minimum standard. A few, however, include other standards; for example, in general the National Industrial Conference Board studies have included a more liberal standard as well as a minimum standard.

Changes in the cost of living, like changes in the general price level, are customarily measured by index numbers. There are two important index numbers of the cost of goods and services bought by low-income city dwellers in the United States, and one of the cost of things bought by farmers for family living. One of the indexes for city dwellers is prepared by the U.S. Bureau of Labor Statistics and the other by the National Industrial Conference Board. The index of the cost of things bought by farmers for family living is prepared by the U.S. Department of Agriculture. None of these indexes proceeds exactly upon the basis of pricing a specific bill of goods at different times and places. Instead, certain items of each of the budget groups are priced and an index of the changes of each budget group is determined. These are then combined to give the general index by weighting them according to the relative importance of each group as disclosed by certain budget studies.[1]

The U.S. Bureau of Labor Statistics' Consumer Price Index[2] is made up of the cost of food, clothing, rent, fuel, electricity, ice, housefurnishings, and miscellaneous items. An index is prepared for the United States as a whole and for each of 34 cities. An index for each of the included groups relative to their cost in the period from 1935 to 1939 is first prepared. A weighted average of these relatives is used for the total-cost figure. The weights now used were derived from a nation-wide survey of the disbursements made by wage earners and low-salaried clerical workers during the period from 1934 to 1936. The average income for the entire group of included families at that time was $1,524. The group weights for the United States are as follows: food, 33.9; clothing, 10.5; rent, 18.1; fuel, electricity, and light, 6.4; housefurnishings, 4.2; and miscellaneous, 26.9.[3] The individual cities have slightly different weights, depending upon their geographical location. In the period immediately prior to the Second World War the index was published four times a year—in March, June,

[1] One advantage of this procedure is that it is not necessary to price all the items in a particular budget group if they have similar movements. The Bureau found the following for example: "A study of the movement of the prices of children's clothing shows that they move very closely with the prices of adults' clothing of similar type. By adding expenditures for children's clothing to those of adults, proper proportions have been preserved within the weights for the clothing index, and a considerable saving in price collection has been effected." *U.S. Bur. Labor Statistics Bull.* 699, "Changes in Cost of Living in Large Cities in the United States," p. 18.

[2] This index was formerly known as the Index of the Cost of Living. Controversies over its validity led to its changed name.

September, and December. During the war the national index as well as those for a number of individual cities were estimated monthly.

The goods and services priced for the index are selected to represent typical purchases of wage earners' families. They are changed as required by normal market developments as well as by wartime conditions. In June, 1943, the list included 183 items. These included the prices of 59 foods, 43 articles of clothing, 12 kinds of fuel, 23 kinds of housefurnishings, and 46 miscellaneous goods and services. Two or more qualities are priced for most articles of clothing and housefurnishings and for some of the commodities in the other groups. Altogether, therefore, prices of 342 different articles and qualities are obtained for the official cost-of-living index in each city. Prices of the items included in the food, fuel, and light indexes are obtained by mail, all others by personal representatives of the bureau. In pricing, the type of goods has been varied from city to city in conformity with the purchasing habits of families. The kind and quantity of goods priced are held constant from year to year as far as possible. The indexes thus furnish no information as to the differences in absolute cost among the cities, but do indicate the comparative rates of change in the cost of goods purchased by low-salaried workers in these places.

The cost-of-living index of the National Industrial Conference Board is very similar in its method of construction to that of the U.S. Bureau of Labor Statistics. The groups included in the index are food, shelter, clothing, fuel and light, and sundries. The Board uses the Bureau's food index, but the indexes for the other groups are independently determined. Quotations are gathered by the questionnaire method from a larger number of cities than those included in the Bureau's indexes, but in general fewer quotations are procured from each city, and from fewer regular sources. The base of the index is 1923. The weights were arrived at by taking the percentage of the total expenditure for each group, after examination

[3] An example of the index for 1940 for the United States is shown below:

	Weights		Group Index		
Food	33.9	×	96.6	=	32.7474
Clothing	10.5	×	101.7	=	10.6785
Rent	18.1	×	104.6	=	18.9326
Fuel, electricity, and ice	6.4	×	99.7	=	6.3808
Furnishings	4.2	×	100.5	=	4.2210
Miscellaneous	26.9	×	101.1	=	27.1959
Cost-of-living index				=	100.1562

of a number of expenditure studies. The index is published monthly for the United States as a whole.

The index of the cost of things bought by farmers for family living is compiled in a manner similar to that described for the other indexes. Individual relatives are determined for each of the included budget groups on the basis of fixed-weight aggregates of actual prices. The indexes for the various groups are combined by weighting each group according to its relative importance in the farm family budget. These weights are based upon estimated expenditures during the period from 1935 to 1939.

It is clear that an index must compare the same sort of quantities. Thus we can price the same bill of goods at two different periods of time, or we can average rates of change in prices between two periods. A more elaborate attempt has been made to measure changes in the cost of a given quantity of satisfaction at different prices. If it can be assumed that we deal with an individual whose tastes remain unchanged throughout the period of observation, and for whom all circumstances capable of affecting choice, except prices, also remain unchanged, the relative income required at the two times can be established within fairly narrow limits. It has been shown by several investigators that this ratio of incomes must lie between the values shown by an index of the weighted aggregate of a constant bill of goods of the type purchased by the individual in the base period and a similar index of a constant bill of goods of the type purchased in the compared period.[1]

The consumer price index refers to a specific bill of goods. Consumers do, however, vary the goods which they consume, and some of these shifts need to be taken into consideration for indexes covering an extended period of time. Pricing a bill of antiquated and perhaps largely unobtainable goods would not provide a very useful picture. The inclusion of cotton stockings and woolen petticoats for women in a current cost-of-living index would be examples. The failure to include new, commonly used articles (such as automobiles) would also lessen the significance of the index for recent years. A shift in the composition of the bill of goods priced is therefore essential for an index extending over a considerable period of time. This is accomplished in two ways: (1) by periodic surveys of family expenditures and entirely new weights in accordance with the findings, or (2) by a

[1] See A. C. Pigou, "Economics of Welfare," Part I, Chap. V, Measurement of the National Dividend; also "International Comparisons of the Cost of Living," International Labor Office Series N, No. 20.

gradual change in the amounts and kinds of commodities in the index. Both methods have been employed by the Bureau of Labor Statistics.

Whether the shift of consumption is one that should or should not be included in the index may be a matter of some difficulty. If, because of an increase in income, consumers buy more and better qualities of goods than formerly, then clearly this is not an increase in the cost of living in a given way, but rather a change in the mode or manner of living. This is exactly what happened in many cases during the war. The consumption pattern of many families changed markedly from its prewar form. Some families consumed larger quantities of food and a larger proportion of higher quality food. Actual food expenditures in the United States at the close of the war were nearly double those at the beginning of the war, while the index of the cost of food had risen by only about 50 per cent. The difference was due at least in part to a larger per capita consumption of food as a whole and to a larger proportion of expenditure on higher cost items such as meats and dairy products.

Additional difficulties arise when goods usually purchased are not available in the market. During the war many articles were scarce. Men's dress shirts, for example, largely disappeared from the market, although their price may not have changed when they could be found. In order to have shirts, purchasers were forced to buy higher priced lines than usual, such as expensive sport shirts. This sort of shift was in reality an increase in the cost of living, although difficult to segregate from a change induced by larger income and largely unaccounted for in the cost-of-living index.

The groups represented in the index of the Bureau of Labor Statistics—wage earners and clerical workers in large cities—comprised about 20 per cent of the total population in the years 1935 and 1936. The other official index based on retail prices is that of the Bureau of Agricultural Economics, and this represents another fifth of the population. Thus about three-fifths of the population is not represented by any published index. This includes those living in the smaller cities and villages and those in other occupational groups than the wage earners and clerical workers.

2. Changes in the Cost of Living in the United States. The consumer price indexes for the United States as estimated by the U.S. Bureau of Labor Statistics are shown in Table 13.

Consumer prices nearly doubled during the First World War, declined rapidly in 1921–1922, by about 15 per cent, and then

TABLE 13. ESTIMATED ANNUAL AVERAGE OF CONSUMER PRICE INDEXES FOR WAGE EARNERS AND LOWER SALARIED WORKERS IN LARGE CITIES, 1913–1947

Year	All items	Food	Clothing	Rent	Fuel, electricity, and ice	House-furnishings	Miscellaneous
1913	70.7	79.9	69.3	92.2	61.9	59.1	50.9
1914	71.8	81.8	69.8	92.2	62.3	60.7	51.9
1915	72.5	80.9	71.4	92.9	62.5	63.6	53.6
1916	77.9	90.8	78.3	94.0	65.0	70.9	56.3
1917	91.6	116.9	94.1	93.2	72.4	82.8	65.1
1918	107.5	134.4	127.5	94.9	84.2	106.4	77.8
1919	123.8	149.8	168.7	102.7	91.1	134.1	87.6
1920	143.0	168.8	201.0	120.7	106.9	164.6	100.5
1921	127.7	128.3	154.8	138.6	114.0	138.5	104.3
1922	119.7	119.9	125.6	142.7	113.1	117.5	101.2
1923	121.9	123.9	125.9	146.4	115.2	126.1	100.8
1924	122.2	122.8	124.9	151.6	113.7	124.0	101.4
1925	125.4	132.9	112.4	152.2	115.4	121.5	102.2
1926	126.4	137.4	120.6	150.7	117.2	118.8	102.6
1927	124.0	132.3	118.3	148.3	115.4	115.9	103.2
1928	122.6	130.8	116.5	144.8	113.4	113.1	103.8
1929	122.5	132.5	115.3	141.4	112.5	111.7	104.6
1930	119.4	126.0	112.7	137.5	111.4	108.9	105.1
1931	108.7	103.9	102.6	130.3	108.9	98.0	104.1
1932	97.6	86.5	90.8	116.9	103.4	85.4	101.7
1933	92.4	84.1	87.9	100.7	100.0	84.2	98.4
1934	95.7	93.7	96.1	94.4	101.4	92.8	97.9
1935	98.1	100.4	96.8	94.2	100.7	94.8	98.1
1936	99.1	101.3	97.6	96.4	100.2	96.3	98.7
1937	102.7	105.3	102.8	100.9	100.2	104.3	101.0
1938	100.8	97.8	102.2	104.1	99.9	103.3	101.5
1939	99.4	95.2	100.5	104.3	99.0	101.3	100.7
1940	100.2	96.6	101.7	104.6	99.7	100.5	101.1
1941	105.2	105.5	106.3	106.2	102.2	107.3	104.0
1942	116.5	123.9	124.2	108.5	105.4	122.2	110.9
1943	123.6	138.0	129.7	108.0	107.7	125.6	115.8
1944	125.5	136.1	138.8	108.2	109.8	136.4	121.3
1945	128.4	139.1	145.9	108.3	110.3	145.8	124.1
1946	139.3	159.6	160.2	108.6	112.4	159.2	128.8
1947	159.2	193.8	185.8	111.2	121.2	184.4	139.9

changed little until the depression, when they declined about 20 per cent more. During the Second World War controls were effective in holding the ostensible increase to about 25 per cent, but there was a subsequent rise when the controls were removed.

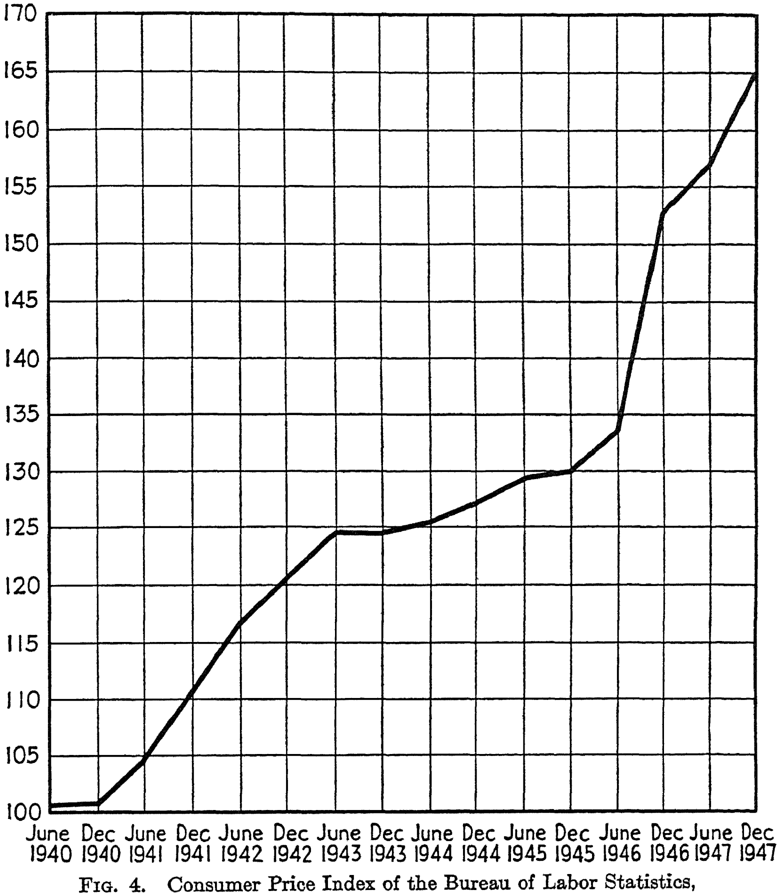

FIG. 4. Consumer Price Index of the Bureau of Labor Statistics, June, 1940, to December, 1947.

The various budget groups that comprise the expenditures of consumers differ in their fluctuations and at times these differences become very large. Thus in the period from 1930 to 1933 food fell the most rapidly of all groups and "miscellaneous" hardly at all. The fall in rents began in 1926 and continued for some time. In both wars the greatest rises were in the food, clothing, and house-furnishings groups.

As previously pointed out, the values of the indexes cannot be taken to represent differences in the cost at a given level of consumption in the different cities. There are considerable technical difficulties in measuring differences in the cost of living from one section of the country to the other, and the U.S. Bureau of Labor Statistics has not undertaken it. The WPA attempted to determine living costs on an *emergency* level, and on the somewhat higher *maintenance* level, for a four-person normal worker's family in 59 cities of the United States at March, 1935, prices.[1] For this purpose an elaborate synthetic budget was priced in each city. The cost of living at the maintenance level ranged from a high of $1,415 in Washington, D.C., to a low of $1,130 in Mobile, Ala., and averaged $1,261 for the entire group of cities. The cost on the emergency level was also highest in Washington, D.C., at $1,014, while the lowest was in Wichita, Kans., at $810. At both levels necessary outlay in the most expensive city averaged about 25 per cent above the least expensive. In more than half the cities, living costs differed within a range of only $100 a year.

TABLE 14. ESTIMATED COST OF LIVING FOR A FOUR-PERSON NORMAL WORKER'S FAMILY AT MAINTENANCE LEVEL AS DEFINED BY THE WPA, IN 33 LARGE CITIES, AS OF JUNE 15, 1943*

City	Cost	City	Cost
Atlanta	$1,641	Milwaukee	$1,686
Baltimore	1,641	Minneapolis	1,704
Birmingham	1,590	Mobile	1,496
Boston	1,717	New Orleans	1,595
Buffalo	1,633	New York	1,816
Chicago	1,779	Norfolk	1,696
Cincinnati	1,667	Philadelphia	1,636
Cleveland	1,764	Pittsburgh	1,694
Denver	1,594	Portland, Maine	1,705
Detroit	1,798	Portland, Ore.	1,687
Houston	1,582	Richmond	1,625
Indianapolis	1,621	St. Louis	1,703
Jacksonville	1,651	San Francisco	1,807
Kansas City	1,541	Scranton	1,671
Los Angeles	1,622	Seattle	1,712
Manchester	1,686	Washington, D.C.	1,809
Memphis	1,635		

* U.S. Bureau of Labor Statistics.

[1] M. L. STECKER, "Intercity Differences in the Cost of Living in March, 1935, 59 Cities," WPA Preliminary Rept, 1937.

The budgets priced were the same in all cities except for a few items. Transportation allowances had to be adjusted for city size and area and allowances made for fuel and ice, to take account of climatic differences.

The WPA budget has been recomputed quarterly by the Bureau of Labor Statistics on the basis of the reported prices secured for its regular index. Since the budget for the regular Bureau index is different, these total costs cannot be used as the costs of the Bureau budget. The costs by cities are shown for June, 1943, in Table 14. The striking feature of these costs is their similarity. There seems to be no distinct regional pattern of living costs for this group.

3. Measurement of Real Income. When prices rise, the quantity of goods that can be bought in the market with a dollar declines. The converse holds true when prices fall. The quantity of goods which the dollar will command at any time is known as the *purchasing power of the dollar.* The dollar will have varying purchasing power, depending upon the sorts of goods that are purchased with it. The goods that are significant for the ordinary consumer are fairly well represented by those comprising the consumer price index of the Bureau of Labor Statistics, and the purchasing power of the consumer's dollar will fluctuate inversely to this index. If we divide the consumer price index in the base period by the index in the given or compared period, the result will be an *index of the purchasing power of the consumer's dollar* relative to the base period.[1]

The income of the consumer in terms of dollars may have risen or fallen over a period of time along with changes in the cost of goods and services. His ability to buy goods at any one time depends both upon the purchasing power of his dollar and the number of dollars which he has available for expenditure. If his income has risen more than the cost of goods and services, then he is able to buy more goods and services, but if it has risen less than prices he will be able to buy less with it. Similarly, on a decline, if prices decline more rapidly than his income, he can buy more; but if prices decline less rapidly, then he will be able to buy less. If incomes are reduced to an index with the same base period as the consumer price index, a division of the index of income by the consumer price index in the

[1] If the index of prices is 100 in the base period and prices double so that the index is 200 in the given period, then the purchasing power of the dollar will be $^{100}/_{200}$, or half as great. If the index of prices were 150 in the base period and 75 in the given period, then the purchasing power of the dollar would be $^{150}/_{75}$, or twice as great in the given as in the base period.

given period will result in an *index of the purchasing power of the consumer* relative to the base period.

The most elaborate attempt to examine real income in the United States by this method is a study by Prof. Paul H. Douglas.[1] Professor Douglas estimated the average annual money earnings of employed workers for each year of the period from 1890 to 1926 and divided these dollar incomes by a cost-of-living index. The results for selected years are given in Table 15. Average annual real earnings

TABLE 15. RELATIVE REAL ANNUAL AVERAGE EARNINGS OF THOSE ATTACHED TO THE MANUFACTURING, TRANSPORTATION, AND COAL-MINING INDUSTRIES AFTER ALLOWING FOR UNEMPLOYMENT*

(1914 = 100)

Year	Real Earnings
1890	107
1895	100
1900	103
1905	110
1910	112
1915	102
1920	123
1925	134

* P. H. DOUGLAS, "Real Wages in the United States, 1890–1926," p. 468.

appear to have increased between 1900 and 1914 by only about 4 per cent, but these earnings were obtained in an appreciably shorter workday. Between 1920 and 1926 there appears to have been an increase of 35 per cent, which came from a gain of 23 per cent for those remaining in the same industry and a gain of 12 per cent through workers' shifting to better paid industries. The gains varied greatly by industries. To these gains, Douglas would add for the period a 5 per cent gain arising from a decrease in the size of the worker's family, 14 per cent for increased free income from the government, 2 per cent for increased private philanthropy, and 7 or 8 per cent for a lower rate of unemployment. All told, there appears to have been about a 55 per cent larger real income for the ordinary wage earner in 1926 than in the 1890's. The principal criticisms of this study have been with respect to the adequacy of its data. It was necessary to construct a cost-of-living index for the period before 1913, and Douglas's index has been questioned on the ground of inadequate sampling (*i.e.*, inclusion of data only from the large cities) and also for an insufficient number of commodities. The

[1] P. H. DOUGLAS, "Real Wages in the United States, 1890–1926."

estimates of the annual money earnings of employed workers have been attacked on the grounds that our data on unemployment are so meager and unreliable as to vitiate any conclusions.

A variation of this method has been employed by the International Labor Office in an attempt to compare standards of living of workers in various countries of the world.[1] The comparison was made for 21 principal world cities on the basis of skilled trades similar in technique the world over. These were: in the building trades, masons and unskilled workers; in the engineering trades, fitters and unskilled laborers; in the furniture trades, cabinetmakers and unskilled laborers; and in the printing and bookbinding trades, hand compositors, machine compositors, and unskilled laborers. For all the occupations covered for each town, the average time wage for a 48-hour week was determined. This wage is then compared with the cost of a "basket of provisions" customarily consumed by workers to determine how many baskets such a wage would purchase. Some variation is permitted in the contents of the basket to allow for differences in consuming habits, and allowance is made for differences in the costs of housing. An indication of the resulting indexes is given in Table 16.

TABLE 16. PURCHASING POWER OF WORKERS IN SELECTED OCCUPATIONS IN VARIOUS WORLD CITIES, OCT. 1, 1926*
(London = 100)

City	Index
Philadelphia	177
Sydney	137
Copenhagen	111
Berlin	61
Warsaw	45
Rome	43

* "Report on the Standard of Living of Workers in Various Countries" C.E.I. 26, International Labor Office, 1926, p. 29.

The critics of this study have maintained that the indexes overstate the real differences between cities. It has been pointed out, for example, that the items not included in the comparison, such as rents and other living costs, are lower on the Continent than in the United States. The representativeness of the included classes as an indication of the situation regarding other workers has also been questioned on the grounds that the wages in these trades in the

[1] "Report on the Standard of Living of Workers in Various Countries," C.E.I. 26, International Labor Office.

United States are higher relative to the general average of wages than in the compared countries. This is because when the study was made these trades were already well organized in the United States, whereas the great mass of the remaining workers were generally unorganized. In Europe, trade unions were generally more important in the other lines and wages closer to those in the included groups. It was also suggested that at that time the European worker had more security in the way of unemployment insurance and old-age pensions. All these elements would seem to give greater equality to the real wage than the indexes indicate.

An example of the comparison of real incomes by selected items or groups is found in a study by M. K. Bennett.[1] Here the following 14 statistical series were reduced to relatives and included: deaths

TABLE 17. INDEXES OF REAL INCOME IN VARIOUS COUNTRIES

Country	Index	Country	Index
United States	166	Germany	110
Great Britain	135	Norway	107
Denmark	130	France	106
Switzerland	125	Finland	50
Holland	118	Italy	49
Belgium	118	Spain	48
Sweden	110	Portugal	28

per 1,000 inhabitants (inverted); births per 1,000 inhabitants (inverted); percentage of population engaged in professional service; percentage of population aged 5 to 20 attending elementary and secondary schools; pieces of mail per capita handled by postal services; telephones per 1,000 inhabitants; mileage of telephone and telegraph per 100,000 inhabitants; telegraph messages sent per 1,000 inhabitants; railway locomotives per 100,000 inhabitants; motor vehicles per 1,000 inhabitants; raw sugar per capita domestically retained; tobacco per capita domestically retained; tea, coffee, and cocoa per capita domestically retained; and citrus fruits and bananas domestically retained. The first five series were used as an index of professional services, the following five as an index of transportation and communication, and the last four as an index of luxury-food consumption, and all were combined in a general index. The resulting general indexes are given in Table 17. They show an appreciably

[1] M. K. BENNETT, Measurement of Relative National Standards of Living, *Quart. J. Econ.*, vol. 51, p. 317, February, 1937.

higher real income judged by these criteria in the United States than in other countries—the British Isles, Denmark, and Switzerland being grouped at a high level; Holland, Belgium, Switzerland, Sweden, Germany, Norway, and France in a middle group; and Finland, Italy, Spain, and Portugal at very low levels. The limitations of the comparison are obvious: the narrow range of the included items and the arbitrary weighting.

By an analogous method, rural-level-of-living indexes have been computed for counties in the United States for 1940.[1] For the rural-farm index the census data used were: the percentage of occupied dwelling units with fewer than 1.51 persons per room, percentage of dwelling units with radios, percentage of farms with gross income of more than $600, percentage of farms reporting autos of 1936 or later models, and median grade of school completed by persons twenty-five years of age and over. These were weighted on the basis of their relative importance as determined by correlations in selected counties. An index including slightly different factors was used for the rural-nonfarm group and the two indexes combined to obtain the county total. The state indexes ranged from 64 for Louisiana to 145 for Connecticut. The range in the individual counties was much larger. Insofar as the indexes have meaning, they indicate an astounding variation in the level of rural living in the United States.

Several of the budget groups offer another indirect measure of real income. Such items as "sundries" or "advancement," for example, show great elasticity. When the percentage of income spent on such items increases, we have an indication of an increase in real income. If we observe the same class over a period of years and find that the percentage spent for sundries or advancement is increasing, we may quite safely conclude that the real income of the group is increasing.

Rowntree suggests a minimum health standard as a means of measuring real income. Such a measure may be accurately defined and remain the same over a period of time. Substitutions may be effected in the things consumed that go to maintain this standard of health, but the measure itself does not vary. The costs of maintaining it do vary with the price level. As the surplus above this

[1] See "Rural Living Indexes for Counties of the United States" (mimeo.), U.S. Bureau of Agricultural Economics, Oct., 1943. Also MARGARET J. HAGOOD, "Development of a 1940 Rural-Farm Level of Living Index for Counties," *Rural Sociology*, vol. 8, pp. 171–180, June, 1943.

minimum increases, the standard ceases to be a satisfactory measure of real wages. The percentage of the total budget that is required to maintain the minimum health standard is a possible measure for comparing real incomes.

The death rate may also be used as an indication of the amount of real wages. For a considerable range, among the low incomes, an insufficient income is quickly manifested in a high death rate, whereas higher incomes show lower death rates. This measure is useful only among people of low-income groups. Among higher income groups a curtailment of real income is manifest, not in the curtailment of subsistence items, but rather in the items of "advancement" or "sundries." These latter, of course, have no effect upon the death rate.

Questions

1. What differences would you expect to find in the cost of living of high-income and low-income groups?

2. Consumers change the types of goods which they buy. How is this taken into account in an index number?

3. One of the stated purposes of the Soil Conservation and Domestic Allotment Act is ". . . (3) to reestablish and maintain the prewar ratio between the per capita purchasing power of farm and non-farm income." What data or material would be needed for determining when this point had been reached?

4. Some wage contracts call for the adjustment of wages according to an index of the cost of living. Do you think it good public policy to have all wages fluctuate in this way?

5. Average hourly earnings in the manufacturing industries in the United States were 55 cents in 1935 and 108 cents in 1946. The cost of living in 1935 was 98 and in 1946, 139. What was the change in purchasing power of an hour of labor between these two periods?

6. On December 20, 1947, the *New York Times* published an analysis of the price of certain consumer items in the U.S.S.R. in terms of their cost to workers in the amount of time spent to earn them. The results are compared with a similar computation for workers in the United States. Make a study of this analysis and report on your findings.

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CHAPTER VI

COMPETITION, MONOPOLY, AND THE CONSUMER

The economic organization of society around a system of prices places the interest of the consumer and the producer in conflict, especially with respect to the most desirable volume of production. The consumer desires the largest possible volume of production and the lowest possible prices. The seller, on the other hand, desires a restricted output with higher prices, resulting in larger profits to himself. Whenever possible the seller will develop devices to restrict the competition from others in his market. He will seldom be able to do this completely, but often will achieve some partial limitation, particularly for short periods of time. Examination will ordinarily disclose competitive forces running through all these situations, however, which prevent a monopoly from being retained for long periods.

The interests of the consumer will usually be best served by competition,[1] since this generally produces a larger output of better products at lower prices than would result when monopolistic conditions are present. This is not always true. It is possible that a monopoly may not use its power to oppress the public; it may simply prevent cutthroat competition in the industry and be content with a normal rate of return on its investments. Such instances are, however, exceptional. It is also possible that the monopoly through its larger scale of operations may be able to reduce costs sufficiently so that, even though it charges a monopoly price, this price may be lower than would have been possible with a larger number of smaller competing concerns.[2] Simple competition will be found when there is a relatively large number of sellers in a market, dealing in a perfectly standardized product or one in which it is impossible to associate qualities with a particular seller, to which market new sellers may enter freely. Merely to enumerate these conditions discloses the rarity of simple competition in modern society and likewise indicates the principal methods by which competition is broken down.

[1] See Thurman W. Arnold, "The Bottlenecks of Business," Chap. II, How Restraints of Trade Affect Your Standard of Living.

[2] See A. Marshall, "Principles of Economics," 8th ed., p. 484.

1. The Nature of Competition. The term *competition* connotes rivalry; usually competitive activity is thought of as being directed toward gaining the custom of patrons at the expense of rivals.[1] Rivalry may be direct (involving two or more vendors offering the same wares) or nondirect (being composed of those selling other items which compete for the dollars of the consumer). Rivalry for custom may manifest itself in a reduction of prices with the hope of inducing a continuation or increase in patronage (*price competition*) or in an attempt to convince customers, by advertising, direct selling, or whatnot, that one's product or service is superior (*nonprice competition*),[2] although typically each is utilized to some extent in varying combinations. In any case, in long-run terms competition is a powerful influence in reducing prices and improving the quality of merchandise. Competition is present in the buying side of the market also; that is, rivalry exists among buyers in procuring supplies and men as well as in acquiring customers.

On the other hand, competition may not involve rivalry in the usual sense at all. Thus there is said to be a high degree of competition in the field of agricultural products, although sellers (farmers) usually do not attempt to take custom from one another; in such situations usually each vendor can sell as much as he produces without affecting any other vendor. There is rivalry, however, even though it is of a very different sort. This may be referred to as *cost competition;* it is directed against unknown rivals and manifests itself in an attempt to keep costs below a market price over which the seller has no control, so that entrepreneurial profits can be earned.

It should be evident from the foregoing that the nature of competition varies tremendously, depending upon the circumstances. Economists have only comparatively recently developed a nomenclature to distinguish different types of competitive situations, and though these are still only imperfectly understood, a consideration of them will be helpful to the student of this subject.

Perhaps the best way of approaching the subject is to visualize *perfect* competition at one end of a scale and *pure* monopoly, or absence of competition, at the other. In between there are different types of what may be termed nonperfect competitive or quasi-

[1] A definition appearing in Webster's New International Dictionary is as follows: "The effort of two or more parties, acting independently, to secure the custom of a third party by the offer of the most favorable terms; . . ."

[2] See TNEC Monograph No. 1, "Price Behavior and Business Policy," Chap. III; see also A. R. Burns, "The Decline of Competition," Chap. VIII.

monopolistic situations; that is, variance in one or more particulars from the perfect competitive situation, yet far short of pure monopoly. These have been given particular designations—*imperfect competition* or *monopolistic competition*—depending upon the form they take. These various forms of competition will be discussed briefly in the following subsections.[1]

Perfect Competition. Perfect competition is an unreal concept but is helpful in understanding realistic conditions, just as vacuum observations by physicists are helpful to an understanding of realistic natural phenomena. Perfect competition would prevail under the following conditions:

1. The existence of a large number of buyers and sellers—so many that the actions of any one would have no appreciable effect upon any other or upon price.
2. Completely informed buyers and sellers, so that both buyers and sellers would know what is being offered and what is being taken and at what prices.
3. Homogeneity (sameness) of wares, so that all vendors would be selling precisely the same product-service.
4. Divisibility and mobility of the factors of production, so that prompt movement of men, materials, and facilities would take place in and out of industry in response to changes in profitability developing out of price variations.

It should be noted that there is a type of competition one step removed from that designated as *perfect*; this we call *pure* competition. It assumes the existence of large numbers of buyers and sellers, a homogeneous product, a large amount of (though not complete) information. This is the situation which prevails in the sale of certain agricultural products (*e.g.*, wheat) where there is a large number of well-informed traders buying and selling a homogeneous product. Thus pure—or at least quasi-pure—competition, in contrast to perfect competition, is a realistic not an abstract concept.

Two generalizations may be made concerning price making under perfect or pure competitive conditions:

1. There can be no individual price policy in such situations.[2] Prices under perfect and pure competitive conditions are *market*

[1] For extended discussions of forms of nonperfect competition see Edward Chamberlin, "The Theory of Monopolistic Competition"; Joan Robinson, "The Economics of Imperfect Competition"; and Robert Triffin, "Monopolistic Competition and General Equilibrium Theory."

[2] Although there might be a governmental price policy with respect to the product of the whole industry.

made (an *automatic* price develops out of buyers' bids and sellers' offers), so that an individual vendor sells at what the market will give or else does not sell at all at the moment. Moreover, his failure to sell will have no effect on the price.

2. Prices tend to uniformity at any one moment of time and constantly fluctuate with short-run changes in demand and supply; theoretically, under perfect competitive conditions the market price would fluctuate around the cost of production of the marginal producer.

Duopoly and Oligopoly. One condition of perfect competition (and part of another) was relaxed to secure the more realistic pure competition, as noted above. If one further condition of perfect competition is relaxed—a large number of sellers—we have an entirely different competitive situation. That is, instead of a large number of individuals offering their product, we now have a very small group. This means that (1) sellers *must* set prices (*i.e.*, they must have a price policy) and (2) the actions of any one seller may have a material effect on the others.

In the case of only two sellers—*duopoly,* so called (the sulphur industry is said to be an example[1]—if one firm decides openly to reduce prices, there is a strong tendency for the other to follow. Otherwise one firm might obtain all of the business at the expense of the other. If one competitor tried to *beat* rather than merely to *meet* the prices of the other, a price war might be precipitated.

The result under such conditions is that a competitor is bound to utilize a great deal of foresight and restraint in connection with his pricing activities. That is, since he is familiar with the details of his own business, it follows that he knows a great deal about his competitor's business. He therefore has some knowledge of the reactions of his competitor to certain moves (which can be confirmed by past experience or by a little experimentation) and will act on the basis of that knowledge. Thus prices under such conditions are often identical for the two sellers except where secret price cutting prevails, and also relatively stable. Fluctuations over a period of time are small and occur infrequently.

Oligopoly—the existence of several sellers—is also likely to be typified by a display of foresight on the part of competitors in pricing their wares. This appears to be the situation in the cement, nickel,

[1] BURNS, *op. cit.*, p. 229.

steel, and match industries, among many others.[1] That is, oligopolists usually will consider the effect of a price change on the business of competitors, as well as the competitors' reaction to such a change. Therefore a firm will usually make a move price-wise, when sellers are few, *only* after considering the total effect of such a move on the market.[2] Because of natural conservatism in the matter of price reductions in some instances (when total demand is inelastic within a considerable range around the price quoted) and the distinct possibility of success in enhancing prices (which depends to some extent upon the business philosophy of competitors) prices may be just as high as in the case of monopolies.

Duopsony and *oligopsony* are the corresponding situations on the buying side of the market; *i.e.*, duopsony is a condition which exists when there are only two buyers and oligopsony the condition obtaining when there are but a few. Somewhat the same reasoning applies to these situations as in the case of duopolies and oligopolies; that is, in general, fewness of buyers often will affect prices paid for materials, facilities, and labor purchased. Two essential differences obtain: (1) prices generally are made by the sellers and are only *accepted* by buyers, and (2) buying activities are much less public than selling activities. Therefore fewness of buyers probably does not have as much effect upon price as fewness of sellers.

Monopolistic Competition. If another rigid prerequisite of *perfect* and *pure* competition is relaxed, namely, homogeneity of product, still another type of nonperfect competition prevails. This type—*monopolistic competition,* so called—is characterized by a number of differentiated products of the same generic class (breakfast cereals, refrigerators, laundry soaps, or whatnot) competing with one another for the buyers' favor. Each vendor has a product which possesses distinctive qualities (at least in the minds of certain consumers) and each seller has a complete monopoly of the supply of this brand or

[1] *Ibid.*, pp. 225–272. See also George P. Comer, Outlook for Effective Competition, *Am. Econ. Rev. Papers and Proceedings,* May, 1946, p. 157.

[2] In some instances competitive firms may react "irrationally." This may be due, on the one hand, to inexperience or, on the other, to the aggressive nature of the top executive combined with some competitive advantage which he enjoys. Very small firms at times may be able to undercut competitors' prices with impunity even when homogeneity of product obtains, simply because they are small and the effect of their action on the volume of competitors' business is not great enough to bring reprisals.

make of product; at the same time each is in active competition with other sellers of quasi-unique products (brands)—hence the term, *monopolistic competition.*

Although this subject will be discussed in more detail below, there are three important points which should be noted in this connection:

1. In such a situation some customers adhere to each seller as a result of an attitude on their part that one product is superior to others.

2. Absence of complete information concerning various offerings often aids a seller in maintaining such adherence.

3. Depending upon the strength of this preference (in terms of both intensity and numbers) higher prices may be charged than would prevail under pure competitive conditions and often with resulting higher profits.

Actually, when sellers are few, product differentiation often exists also. Thus, combined with oligopolistic conditions are monopolistic competitive conditions. Such a combination might make a considerable difference in the competitive behavior of rivals. Moreover, other factors not mentioned in the simple classification given above are important in pondering competitive behavior. For example, whether the commodity dealt in is durable or nondurable may have an important bearing on the price policies of those engaged in the business. Likewise, whether the product sold is a consumer's good or a producer's good is bound to affect competitive behavior; also whether there are few or many buyers is likely to have an important bearing on the price policy of the seller. In fact, there is an almost infinite number of combinations of factors which have an influence on the price policies of business firms.[1]

One further point should be made in this connection: while fewness of competitors and product differentiation undoubtedly tend to make for price stability and "stickiness," oligopolistic and monopolistic competitive situations are essentially *competitive*, not monopolistic; that is, in each type of activity or a combination of the two, rivals characteristically vie with each other for custom. As a result, over a period of time, though the process may be slow, prices are likely to decline with improvements in techniques, etc. Often a decline in price may be in the form of a more efficient or a longer lasting product. As a matter of fact, it is probably characteristic for nominal prices to decline at the same time as improvements in quality are

[1] For some of the variables see J. S. Bain, Market Classifications in Modern Price Theory, *Quart. J. Econ.*, August, 1942, p. 573.

made. Such an instance is found in the refrigerator field, where the average factory price of machines dropped 50 per cent from 1927 to 1933[1] (before the advent of aggressive competition), at the same time as the length of life of the machines was increasing and upkeep cost declining.

Briefly, then, while the forms of nonperfect competition discussed above normally are not characterized by aggressive price cutting, they are a form of competition and, given time, will bring about a decline in prices and an increase in quality of product. One should hasten to add that at times fewness of sellers or product differentiation does *not* make for the conservative type of competition pictured above, because of the presence of an aggressively minded rival, combined perhaps with some competitive "advantage" which he possesses[2] or some special situation into which he is forced.[3] Actually, even when no such individual is present, if entrance to the field is unrestricted such a person may decide to toss his hat into the ring at any moment. Obviously, when competitive conditions are thus altered the effect on the price structure will be substantially different.

2. Market with a Single Seller. As was mentioned above, the production of each seller under *perfect* or *pure* competition is such a small part of the total that any variation he makes in his output will have an infinitesimal influence upon price.[4] He finds it profitable to expand production as long as each unit of his increase adds more to total revenue than to total cost. He is thus led to expand production to a point where his costs have increased sufficiently per added unit to equal selling price.[5]

Pure monopoly, as was suggested, is a complete absence of competition. What are known as monopolies in the economic system as it

[1] TNEC, *op. cit.*, p. 255; see also N. H. Borden, "The Economic Effects of Advertising," p. 617.

[2] This advantage may be genuine, as in the case of Sears in the sale of appliances (see p. 88). However, it may only be an advantage in the sense that it allows him (because of his small size, say) to take aggressive action which would not be tolerated from others. Somewhat similar, but a converse case, is the situation of a block-long service station whose fixed costs are such as to encourage a volume-building cut-price policy.

[3] It may be that aggressive price cutting where sellers are few is due to a real *disadvantage*, as in the case of a company competing in a field where one brand is so firmly entrenched as to require the competing company to cut below the market if consumer acceptance is to be expected at all.

[4] The influence of elasticity of demand is explained in Chap. X.

[5] It is to be recognized that uncertainties enter to upset calculations in the short run.

actually exists fall far short of this abstract idea of one seller with no close substitutes for his product. Actually monopolies as they exist in the business world are situations where a large, though not complete, degree of control exists over the supplies of a particular product; very likely, as in the aluminum industry, various substitutes exist, depending upon the use to which the product is put. As a matter of fact, the competition furnished by a substitute product may be much more effective than that provided by a direct rival. Paper milk containers as against glass bottles are a good example of this.

In the abstract, at least, if there is a single seller in the market the situation is changed with respect to the demand curve from that which exists under pure competition. Since the seller has control of all the product, he may alter market supplies sufficiently to cause prices to rise.[1] The output under monopoly will thus be smaller than under competition, with higher prices resulting. It should be noted, however, that monopoly price is not necessarily an inordinately high price; it is the price which in the short run will yield the greatest net revenue, given a certain demand and cost situation. The monopoly, also, will make less demand for labor and capital than it would under competitive conditions, and these must find employment in other fields that may be open to them. The effects of the monopoly are not, in consequence, confined to the higher prices charged by the monopolist, but extend to other fields as well. Just because monopolies are in many respects socially disadvantageous it does not follow that it would be a sound policy to atomize large, powerful concerns, since there is a distinct possibility of losing certain advantages of large size thereby and of failing to gain those of small size in the process.

As suggested above, a single seller seldom will be able to secure complete control of a market; even if secured, the control will be difficult if not impossible to hold. In actual fact one phase of a business may be characterized by monopolistic practices while another phase is highly competitive (as in the motion picture industry, where a firm might be involved in noncompetitive activities in the sale of films while engaging in "dog-eat-dog" competition in the purchase of story material and talent). Moreover, monopolists are likely to differ materially, in their activities, as to perspicacity in discerning

[1] In the long run, potential competition becomes actual competition if high prices are exacted, assuming that entrance is unrestricted. This suggests that restricted activities probably are one of the most serious enemies of a workable competitive system.

their own best interest, foresightedness with respect to long-run effects of their policies on demand and competition, and ability to estimate the chances of governmental interference. Aside from those established by unfair tactics, there appear to be four circumstances under which complete monopolies may be established.[1] (1) The first is the rare case where one group has control of one or more essential raw materials entering a final product (the aluminum industry might be an example of this). (2) The second occurs when the state grants an exclusive patent for some mechanical device or a copyright to the work of an author (the United Shoe Machinery Company will serve as an illustration of this type of thing). Such rights in the United States have limitations as to the time over which they extend. (3) There may be economies arising from large-scale production which permit the larger plant because of lower costs to drive competitors from the field, and this is an important source of monopoly in restricted markets (although it is difficult to find an example of this in actual practice). (4) The most important group are those secured by a grant, by governmental authority, of exclusive right to sell a commodity or service in a particular market. The public utilities, such as telephones, street transportation, and the supply of gas, water, or electricity to the public, are common examples. Most of the so-called *monopolies* in the United States, except those arising from patent rights or the public utilities, are in reality only partial monopolies.

The public-utility monopolies are important because of the considerable proportion of the consumer's income that is expended for their services. The National Bureau of Economic Research estimated some time ago that around 10 per cent of the national income is produced by privately owned public utilities.[2] The characteristics that generally distinguish the businesses designated by the legislatures and the courts as public utilities are (1) that the business must be one which supplies some service essential to a civilized existence, although not necessarily an absolute necessity; (2) that the service must also be one sold generally to the public; and (3) that there must be a tendency for the business to become a monopoly. The utility usually operates under an exclusive grant to supply services in the community. The measures used in setting the rates for utilities will be explained in Chap. VII.

[1] See GARVER and HANSEN, "Principles of Economics," rev. ed., p. 189.

[2] SIMON KUZNETS, "National Income 1919–1935," *Nat. Bur. Econ. Res. Bull.* 66, p. 5, Sept. 27, 1937.

A seller sometimes secures not only a monopoly but also an ability to discriminate or to treat different buyers differently by making a disproportionately lower price to some than to others, relative to the product-service supplied. Such a monopoly is known as a *discriminating monopoly,* in contrast to a simple monopoly where equal terms must be extended to all customers.[1] Briefly, however, discriminatory pricing is aimed at more nearly obtaining the full demand price of each consumer, and thus maximizing net revenue. The advantages of such a division of the market are more definitely pointed out in the discussion of demand.[2] If this power were benevolently exercised, a great deal of good might be done, but it will seldom be in the interest of the monopolist to exercise his power in this way. A discriminating monopoly will yield the monopolist a larger profit than a simple monopoly; in consequence, the monopoly will classify its customers and charge each class a different price whenever possible.

It does not follow that price discrimination is always bad for the consumer. Sometimes it permits production where none would be possible otherwise. It may happen, for instance, that a railway would not be built, or a country doctor would not set up in practice, if discrimination were forbidden.[3] There are many other areas in which price discrimination appears to be a boon to consumer welfare.[4] Nor does this mean, on the other hand, that monopoly is required in order to practice price discrimination—rather, merely nonperfect competition. Discrimination is advantageous to the group that secures a lower price because of it, and detrimental to the group whose price is raised by it. If for some reason we judge the gains to one group more important than the losses to the other, as we might if the group to which the price was lowered was composed largely of poor people and the one to whom the price was raised largely of rich people, then we might decide that discrimination was desirable. Furthermore, in special cases prices in the higher priced market may be lowered when costs fall because of enlarged output, and this may be the case where the more elastic market is an export market in which exported goods compete with local production.[5] Any advantage the

[1] See A. C. Pigou, "Economics of Welfare," 1st ed., pp. 240–256; see also Ralph Cassady, Jr., Some Economic Aspects of Price Discrimination under Non-perfect Market Conditions, *J. Marketing,* July, 1946, p. 7.

[2] See Chap. X.

[3] Robinson, *op. cit.,* p. 203.

[4] See Ralph Cassady, Jr., Techniques and Purposes of Price Discrimination, *J. Marketing,* October, 1946, pp. 135–150.

[5] See Robinson, *op. cit.,* p. 205.

consumer may gain from discrimination is incidental to the gains of the monopolist, although output will, in general, be greater under a discriminating than under a simple monopoly.

3. Monopoly with Several Sellers. Assuming an absence of concerted activity, the probability of developing the gains of a monopoly declines greatly as the number of sellers increases. When sellers are few and the product sold by all firms is identical, one of three general conditions may develop: the firms may reach an agreement with respect to prices, which will usually contain a considerable element of monopoly; they may compete freely in the market, with competitive or cutthroat prices resulting, and sometimes elimination of competitors by a subsequent monopoly; or they may act with foresight and restraint as oligopolists, each taking into account the probable moves of the other.

One of the devices developed in situations where there is a substantial number of sellers has been the trade association. These are organizations of firms producing similar lines of goods and are found in a wide variety of fields. Some are relatively unimportant while others, such as those in the iron and steel and electric-power fields, are of great importance. Through the association or *institute*, as it is frequently called, the members exchange information and oppose legislation and taxes believed detrimental to the group. The associations also seek to discourage ruinous competition among the members, and at times have no doubt succeeded in establishing monopoly prices and practices in the industry and have kept inefficient producers in existence. In other cases, the provision of information has no doubt led to improved techniques and more orderly production. Unless carefully restrained, however, the associations are certain to result in the development of monopolistic practices detrimental to the consumer.[1]

4. Market Leadership. In some lines a single large concern dominates the market, with a number of relatively small competitors. The United States Steel Corporation would be an example of this form of nonperfect competition, likewise the large oil concerns in certain sections of the country, and a single distributor in some milk markets. It is usual, in such circumstances of what might be termed *conservative leadership*, for a large concern to set the price for the market and the others to adjust theirs accordingly. They will follow often because of fear of reprisals and because the price umbrella held

[1] For a discussion of trade association activities see C. S. Tippetts and S. Livermore, "Business Organization and Control," rev. ed., Chap. XIII.

up by the large firm gives followers an adequate and stabilized margin of profit. Often the smaller concerns sell for lower prices but remain unmolested because they are not expected to survive, due to their relative inefficiency or because they are too small to affect adversely the leader's position. Should the small concerns become important, attention would have to be directed toward their activities, if only for defensive purposes. Price leadership of the conservative type underlies basing-point pricing schemes, where prices are quoted delivered and are set by those mills whose base price plus freight to destination is the lowest combination of base price plus freight from any of the basing points. Thus price leaders in an industry may vary from area to area and even from time to time. The essential point is that when one firm takes the lead, the others follow. Price leadership of the type described above, incidentally, is not considered by the courts to be collusive and therefore has been judged quite legal.[1]

There is such a thing as *aggressive leadership* also. Such a condition obtains when some monopolistic competitor (technically speaking), who is large enough to materially affect his rivals' business, decides to go actively after sales by reducing prices rather than by merely using demand manipulative efforts. In such an instance the aggressive leader should be so situated as to be able to compete advantageously against the field under aggressive selling conditions. Even under monopolistic competitive conditions rivals will be forced to follow the leader at least part way in his price reductions.

One of the best examples of this sort of thing in the past is the Ford Motor Company in the automobile field; a more recent example is Sears, Roebuck & Company's entrance into the refrigerator field. The latter situation is especially interesting.[2] In 1934 Sears, Roebuck sold only 59,000 electrical refrigerator units, or 5 per cent of the United States total. At that time they were selling their 6-foot model for $124.50, or $40 under the price of comparable models

[1] See George P. Comer, Price Leadership, *Law and Contemporary Problems*, Winter, 1940, pp. 61–73. The United States Supreme Court made its position quite clear in *United States v. International Harvester Company*, 274 U.S. 693, 708 (1927) when it said: ". . . the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination." See also Burns, *op. cit.*, Chap. III. But see the recent cement decision (*Federal Trades Commission v. Cement Institute et al.*, 68 Sup. Ct. Rep. 793, 1948) which clouds the issue considerably.

[2] Most of the facts upon which this example is based are taken from The Nudes Have It, *Fortune*, May, 1940, pp. 102–106.

offered by their competitors. It evidently took some time for the aggressive price tactics of this mass distributor to take effect; by 1939, the Sears Company sold 285,000 units or 14.8 per cent of the field as against 17.7 per cent by Frigidaire and 17.1 per cent by General Electric, the two companies which were in the lead in terms of units sold. At that time the price gap had been materially reduced, but not eliminated.

There is little question but that other companies in a real sense consider Sears the market leader; that is, Sears is an aggressive competitor and makes the moves price-wise to which others must be alert and in part, at least, ready to meet. The advantages that Sears have in this instance as well as in the sale of other durable lines are that (1) intra-industry selling effort is eliminated entirely in that company's system (as between manufacturer and wholesaler as well as between wholesaler and retailer) and (2) potential customers abound in the vast traffic which normally passes through their stores, each shopper being (a) in the mood to buy and (b) at least partially sold on Sears stores as evidenced by his presence there. All of this manifests itself in lower sales costs to the ultimate consumer; objective evidence indicates that the selling and distribution cost involved in the handling of refrigerators by a mass distributor was about half that arising out of handling a comparable box sold through orthodox channels just before the war.[1] It should be clear that a firm such as this is in a position to assume a role of aggressive price leadership and that it stands to gain when it takes advantage of the opportunity offered. At the same time the consumer reaps an advantage by the introduction of aggressive competition into an otherwise conservative situation.

5. Brand and Other Quasi Monopolies. Where the products of one seller can be differentiated from those of other sellers, a type of quasi-monopolistic action is possible which does not prevail when all products are identical. In fact, such conditions (to which we give the designation *monopolistic competition*) are essentially the same as those prevailing when there is one seller in an industry (monopoly), in which, however, practicable substitutes are available to buyers. Consequently this monopolistic competitive situation is analyzed in economic theory in precisely the same way as if genuine instead of quasi-monopolistic conditions existed.

A product is differentiated when any significant basis exists for distinguishing the goods of one seller from another. The basis upon which they are distinguished may be real or imagined, but is of impor-

[1] TNEC, *op. cit.*, p. 145.

tance so long as it results in any preference on the part of the buyer. As is indicated in the chapter on demand manipulation, differentiation of product is a primary objective of advertising. Typical examples of successfully differentiated products would be the case of Bromo Seltzer, Alka Seltzer, Sal Hepatica; Ford, Chevrolet, and Plymouth; and Chesterfield, Old Gold, Lucky Strike, and Camel. The essential notion here is that some degree of restriction of competition exists among the products because of consumer preference for one rather than the other.[1] The development of a special market provides scope for monopolistic action on the part of the seller, and such differentiation and the resulting special market will be sought whenever possible.

The results have been well stated by Garver and Hansen as follows: "As long as many customers prefer one seller's wares to those of another, so long will the seller be able to reduce output and confine his sales to those who are willing to pay higher prices. When this condition has prevailed for a time, the sellers may become so numerous that none can sell a sufficient output to enable him to reach the lowest total unit cost even though he should offer to sell at a price equal to that cost. There is not enough volume of demand to go around. By contrast, pure competition would force prices down to the lowest total unit cost of the typical sellers. It would do this by eliminating some of the sellers, by assumption, the least efficient. It therefore appears that the building of clienteles is one of the causes of overcapacity in certain lines of business, chiefly those in which manipulation of demand is most easily accomplished."[2]

The result of such monopolistic competition will be a higher normal price than under pure competition, and where expenditures are made for advertising and differentiation a still higher price might result. The volume of output usually will be less than under pure competition, but not necessarily so if selling costs are incurred, although even

[1] That preferences are strong in some fields is beyond question. For example, the *Milwaukee Journal's* analysis of consumer buying habits for 1944 reveals that 93.6 per cent of all families using hot oat breakfast foods purchased Quaker brand (although, interestingly enough, only 5.6 per cent of those using hot *wheat* breakfast foods purchased Quaker Farina, which is sold in competition with Cream of Wheat); 83.9 per cent of those using a liquid dentifrice purchased Teel; 63.0 per cent of those using cola drinks purchased Coca Cola; 57.8 per cent of those using a packaged vegetable shortening used Spry (with 44.9 per cent purchasing Crisco), etc. See the *Milwaukee J.* "1944 Consumer Analysis of the Greater Milwaukee Market" (21st Comparative Report).

[2] GARVER and HANSEN, *op. cit.*, p. 200.

here the probability is that output will be less. The prices, however, probably would be lower and output greater than they would be under the monopoly of the single seller or an agreement among sellers. The extent to which prices are higher under monopolistic than under pure competition depends upon the special circumstances of particular cases. The prices of drugs, tooth paste, and cosmetics evidently are greatly higher, but one suspects that automobiles may not be appreciably so. We know that in many instances substantial price differences exist between competitive products which are essentially the same in quality. For example, Cream of Wheat sells for from 20 to 55 per cent more than competitive farina cereals, depending upon the size of the package and the competing brand under consideration; indeed, Bayer aspirin sells for from 50 to several hundred per cent more than other brands of acetylsalicylic acid. And so it goes in other fields, although in some instances, because of a fear of loss of business over time, perhaps (due to the tendency of consumers to seek out substitutes), or possibly the existence of adequate consumer information at the moment, which precludes a substantial difference, the best products sell for very little more than those which are less well and favorably known. Sometimes it appears that the advantage sought by a leading brand promotor is in terms of increased volume rather than an enhanced price.

Location also may provide a partially sheltered market. A retailer may supply services to a neighboring community, but there may not be enough business for two or more concerns to operate efficiently in the locality. The new competitor if enlightened is not likely to enter unless he believes that he can operate more efficiently and drive out the present retailer, and in consequence no local competition is apt to appear. This situation provides the present business with some slight monopoly advantages basically similar to those enjoyed by brand promoters. The retail market is in some degree of such a character, particularly in the sale of convenience goods; although, as will be pointed out later, indirect competition vitiates this condition to a considerable degree.

6. Market Exclusion. It will be to the advantage of a group operating or selling in a market to build barriers to the entry of others into that market in order to provide a monopoly or a partial monopoly for themselves. Except in a few special cases, such as some health and sanitation requirements which safeguard consumers, market exclusion will be detrimental to the consumer by forcing him to pay higher prices for commodities and services than would be necessary without this

exclusion. The extent of these practices in the modern economy is seldom realized.

In Foreign Trade. One of the more important and most widespread types of market exclusion is that provided by tariffs. Our import duties place burdens upon the sale of certain foreign-made goods in the United States. Tariffs wherever effective must be bad for consumers, since they raise the price of the commodities in question. The results of a tariff depend a great deal upon the type of goods on which it is levied. Some goods are produced at lower costs in the United States than in other countries and are in consequence exported. A tariff placed on such goods by this country will have no influence on prices or domestic consumption, since none of these goods are imported anyway. Another type of goods, such as bananas, tea, and silk, is not and cannot well be produced in this country because of costs, and some quantities are likely to continue to be imported even in the face of higher consumer prices caused by a tariff levy, or an increase in the tariff rate. If the foreign producers have no other markets in which they can sell and cannot shift to the production of other products, then as long as they continue to supply the same quantities to us as formerly, and other things except for the tariff are unchanged, they must take a lower price while the domestic price remains the same. If, however, the producers curtail sales in this country, then our prices will be higher. If these producers have many alternative markets or other productive opportunities, then our own price will be raised by nearly the full amount of the tariff. The government will receive as revenue at least as much in the form of import duties as the increase in the cost to the consumers. Any justification of such a tariff must be on the grounds that these imported goods form the basis of or a part of a desirable system of raising revenues.

The majority of the commodities on which tariffs are levied are those which can be produced both in this country and in other countries as well. The tariff then permits production in this country when none would otherwise be possible or permits a larger proportion of the supply to be produced domestically than would otherwise be possible. If the tariff is high enough to keep out all imports, then the government derives no revenues from it and the increased price paid by consumers is a bonus to the domestic producers. Where the goods are partly produced in this country and partly imported, the higher price paid by the consumer increases the tax revenues of the government on the imported goods and acts as a bonus to the domestic producer on the goods produced in this country.

The calculation of the cost of a particular tariff to domestic consumers is a matter of considerable technical difficulty. As long as goods are imported, domestic prices will exceed prices in world markets by the amount of the tariff. This may be occasioned by a rise in domestic prices or a fall in world prices because of our smaller takings, or more usually by a combination of the two. The relative importance of the two factors appears to depend to a large extent on our relative importance as an importer of that commodity in the world market and the alternative opportunities of the producers of the product. The greater our relative importance as an importer and the less the opportunities of the producers to switch to other lines of production, the less likely are our domestic consumers to bear the full burden of the tariff.

Sugar may be taken as an example; with respect to this commodity former Secretary of Agriculture Wallace has written:[1] "It is estimated that at current prices American consumers are obliged to pay more than $350,000,000 per annum in excess of the value, at world prices, of their annual sugar supply (without allowance for the estimated net revenue of approximately $47,000,000 represented by the difference between disbursements under the Sugar Act of 1937 and receipts from the tariff and the 50c tax on sugar, or for the possible increase in world price that might result from changed conditions). This is equivalent to a tax of approximately $2.70 per capita on a population of 129 million persons. It means on the average a levy of more than $10 per family. . . ."

In Domestic Trade. A frequently used device for market exclusion is that of taxation. If taxes are laid on the competing product or marketing agency, then the costs or prices of that commodity or agency are raised and competition from this source is lessened or eliminated. The taxes on oleomargarine are an example. The Federal government imposes a tax of ¼ cent a pound on uncolored oleomargarine and 10 cents a pound on yellow or colored oleomargarine. In addition there are special taxes on manufacturers and handlers.[2] Twenty-five states in 1948 had taxes on oleomargarine in some form. Nineteen states have per pound taxes that apply to oleomargarine sold within the state, ranging from 5 cents per pound in Iowa to 15

[1] Letter of Secretary Wallace to Hon. Robert J. Bulkley, U.S. Senate, Mar. 1, 1938.

[2] Manufacturers are subject to special taxes or licenses at the rate of $600 a year. Wholesale dealers handling colored oleomargarine pay $480 a year and those handling uncolored, $200. Retail dealers pay $48 a year to handle colored oleomargarine and $6 a year for selling the uncolored product.

cents per pound in Washington. In other states, taxes are levied on special kinds, such as those containing foreign fats or oils, or more than a certain percentage of vegetable oils—depending on whether the state produces cotton, cattle, or dairy products.[1] The effect of such a tax must be to exclude oleomargarine from many markets and enhance the competitive position of competing fats and oils.

Often taxation is employed to limit the expansion or eliminate certain types of marketing organizations. The chain-store taxes, discussed elsewhere, are examples. In 1937 anti-chain-store legislation existed in 22 states and bills were pending in 7 others.[2] In addition a number of cities and towns levy additional taxes on organizations operating chain stores in them. Such taxes were first used in 1925 and were moderate, but beginning about 1930 the legislation has become increasingly drastic. The taxes in Louisiana, Florida, Iowa, Pennsylvania, and Texas have been especially heavy. A Twentieth Century Fund study has stated:

"The present chain store taxes illustrate special interest legislation that is basically unsound. . . . If chains have a competitive advantage owing to the economies of the chain type of organization, the public benefits from it in low prices. We oppose the use of the taxing system, or any other device, to maintain the status quo for the benefit of those who would be injured by new methods of competition that benefit the public. The chain store taxes seem to have been used for this purpose."[3]

The license fees charged hucksters and peddlers, roadside-stand operators, and others are frequently designed to eliminate them from the market rather than for any regulatory or revenue purpose.

A somewhat analogous situation is found in the case of resale price maintenance. Resale price maintenance permits the manufacturer to specify the price at which goods sold by him are to be sold by both the wholesaler and the retailer. It is aimed primarily at curtailing the activities of agencies depending largely upon attracting consumers by low prices, such as the chain stores, mail-order houses, and department stores. All but three states now have laws permitting resale price maintenance, mostly passed within the last few years, and the Tydings-Miller Act of 1937 is a Federal act permitting manufacturers

[1] See Ralph Cassady, Jr., Trade Barriers within the United States, *Harvard Bus. Rev.*, Winter, 1940, p. 232.

[2] For examples of types of taxes see Federal Trade Commission, "Final Report of Chain-store Investigation," pp. 80–81, 1935.

[3] Twentieth Century Fund, "Facing the Tax Problem, 1937," p. 503.

to make resale contracts with retailers in states that have Fair-Trade laws without fear of Federal antitrust laws. These laws tend to exclude certain types of agencies from the market, although they probably are not so drastic as the tax legislation directed against chain stores.

Sellers of products may agree among themselves to a restriction of supplies or proration of the market. Sometimes these are gentlemen's agreements and sometimes marketing devices utilized by cooperatives having a considerable portion of the supplies. In the case of agricultural products, there has also been some legal sanction. Thus the marketing and licensing provisions of the Agricultural Adjustment Act and the California Agricultural Prorate Act legalize such procedures. Under these, a central body decides upon the total quantities to be sold and their allocation to particular markets, presumably selecting an arrangement that will raise the returns to producers.[1] Such a plan prevents some from selling the quantities or qualities, or from doing so at a time when they otherwise would. It is a form of discriminating monopoly. Under the AAA there have been 25 distinct products for which active operations have been undertaken in the *general crops* group.[2]

7. The Control of Monopolies. It has been the policy in the United States for well over 50 years to oppose by legislation monopolies and restraints-in-trade. Even before the enactment of the Sherman Antitrust Act in 1890, however, monopolistic activities were curbed by common law rulings. Thus under the common law (as in England at present) monopolistic agreements were unenforceable in the courts.

In the United States at present we have not only the Sherman law and the Clayton and Federal Trade Commission acts, but, for what they are worth, state antitrust statutes as well. However, there are certain areas which are almost, if not entirely, beyond the pale as far as government control of monopolization is concerned. Thus, our antitrust laws are largely, if not entirely, inapplicable in the fields of agriculture, labor, and public-utility industries (although these are regulated) as well as in connection with joint action by American

[1] Among the devices commonly used are the following: (1) exclusion of inferior grades or sizes from shipment; (2) temporary embargoes on shipments; (3) restriction of supplies in specified markets; (4) curtailment of shipments during specified periods; (5) limitation of total supply whose shipment or sale will be permitted during the whole marketing season; (6) diversion of part of the crops to secondary uses.

[2] E. G. Nourse, "Marketing Agreements under the AAA," p. 358.

exporters and the sale of patented products, and are at least partially abrogated in connection with the sale of branded articles in states having Fair Trade laws.

There are, however, large areas which lie within the orbit of the antitrust laws and in these much has been done and is being done toward controlling monopolistic activities.[1] Our legislation provides for both punitive and remedial measures; fines and prison terms may be exacted and the offending company may even be dismembered.[2] Some more or less clear-cut inferences may be drawn as to activities at present considered illegal. A brief statement concerning activities which are condemned by our antitrust legislation, in contrast with those which are condoned, follows:

1. The use of certain types of business organizations for purposes of corporate control has been outlawed by judicial decision. Thus the use of trust form for concentration purposes was declared illegal in the North River Sugar Refining Company and Standard Oil Company of Ohio decisions.[3] The pool has been outlawed in much the same way.[4] However, holding companies have not been so judged, nor has the consolidation.[5] It is very possible that an activity that would be quite legal if accomplished by bringing companies together under one ownership would be illegal if cooperative means among separate companies were utilized to accomplish the same purpose.

2. Regardless of the type of organizational form utilized, monopolization has been declared unlawful in Sec. 2 of the Sherman Act. However, the size of a company has no important bearing on whether the organization is to be judged monopolistic in the eyes of the law, and even the degree of control of the market is not a decisive factor. On the other hand, intent to monopolize has been emphasized and indulgence in predatory practices has an important bearing on the question also.[6] Actually, every antitrust case is judged on its merits

[1] See TNEC Monographs No. 16, "Anti-Trust in Action," 1940; and No. 38, "Study of the Construction and Enforcement of Anti-trust Laws," 1941.

[2] See the discussion of the dissolution of the old Standard Oil and American Tobacco Companies in C. S. Tippetts and S. Livermore's "Business Organization and Control," 2d. ed. pp. 417–420.

[3] See "Owens, on Business Organization and Combination," rev. ed., Chap. XVII.

[4] *Ibid.*, Chap. XVI.

[5] *Ibid.*, Chaps. XIX and XXI, respectively.

[6] See TNEC Monograph No. 38 for an extended analysis of the various factors which have been considered important in deciding whether monopolization exists within the meaning of the law.

by an application of the "rule of reason" which in effect distinguishes "good" and "bad" monopolies and condemns the latter.[1]

3. The use of price agreements among competitors has consistently been condemned as unlawful within the meaning of the antitrust laws. In the Trenton Potteries decision this idea was expressed most clearly, the court indicating that *no* agreement on price would be considered reasonable and thus legal, assuming of course that the Federal courts had jurisdiction.[2]

4. Agreements or arrangements for dividing markets, which results in individual sellers controlling particular areas, manifestly is a method of eliminating competition and thus is considered an illegal activity; the rule was laid down in the Addyston Pipe and Steel Company case[3] and appears to have been followed by the courts since.

5. Restrictive activities affecting entrance of competitors, if not practiced under the legal sanction of the patent laws, milk inspection laws, etc., are prohibited;[4] in fact, this type of restraint is in some ways the most serious of all because it tends to prevent adjustments in supply which are expected to take place in our economic system when high prices prevail.

Besides the Sherman Act, on whose authority the foregoing prohibitions are based, we have both the Clayton and Federal Trade Commission acts. The former, among other things, (1) by the terms of Sec. 3 outlaws tying agreements, with their tendency to prevent buyers from patronizing competitors by requiring the utilization of patented articles only in connection with supplies furnished by the seller of the patented commodity; (2) by the terms of Sec. 7 prohibits stock acquisitions by corporations in another corporation where the effect may be substantially to lessen competition between the two

[1] *Standard Oil Company v. United States*, 221 U.S. 1 (1911).

[2] *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927).

[3] *Addyston Pipe and Steel Company v. United States* 175 U.S. 211 (1899).

[4] For example, the National Cash Register Company in an earlier period, not satisfied with the competitive advantage it enjoyed through the good will of its customers, actively engaged in predatory activities against competitors. In a consent decree signed Feb. 1, 1916, it agreed (among other things) to cease inducing violation of contracts, soliciting trade secrets from competitors' employees, circulating rumors concerning competing companies' financial condition or efficiency of product, unfairly influencing prospective purchasers against competing machines, intimidating prospective purchasers against competing machines, and intimidating prospective competitors in the cash register field. *United States v. National Cash Register Company* Inequity No. 6802, "Decrees and Judgments in Federal Anti-trust Cases," July 2, 1890, to Jan. 1, 1918, p. 315.

firms; and (3) by the terms of Sec. 8 proscribes interlocking directorates among competing companies having assets of over a million dollars.[1] The Federal Trade Commission Act (discussed in detail in a later chapter), which now prohibits unfair practices in commerce, in a sense is intended to nip monopolies in the bud.

A new and a somewhat perverted attempt at legislative control of monopolies has been introduced during the last decade and a half in the form of state Fair Trade and Unfair Practice laws. The emphasis here has been toward controlling intensive price competition by large competitors who, because of their size, are erroneously presumed to be monopolistic per se. Thus this legislation is designed to hobble large competitors by preventing such competitors from competing freely price-wise. An evaluation of this type of legislation will be found in Chap. XVI.

Antitrust laws of course have an application in situations where sellers are few or where trade-name monopolies prevail only when collusive or predatory activities are engaged in. Thus companies are free to make a superior product, to promote it as best they can, and to gain as large a share of the market as they are able to acquire by fair means. In so doing, they may set a price on their product which will be followed by others or may, on the other hand, follow the price of some competitor with impunity just so long as collusion does not prevail. But when unfair means of gaining custom are practiced, business is vulnerable and government agencies rightfully move in with what is hoped will be a resulting depressant tendency on prices.[2]

Examples of voluntary agreements among a large group and through cooperative action are found in the milk markets of nearly

[1] According to Dr. Corwin D. Edwards (An Appraisal of the Anti-trust Laws, *Amer. Econ. Rev. Papers and Proceedings*, May, 1946, p. 180), "The provision about interlocking directorates has little meaning, since the same business interest can be represented in the directorates of competing corporations through the simple device of placing on the various directorates different persons who are partners in the same law firm, officials of the same corporation, or members of the same family."

[2] According to George R. Comer (The Outlook for Effective Competition, *Amer. Econ. Rev. Papers and Proceedings*, May, 1946, p. 161), ". . . when several firms were competing . . . [tungsten carbon] sold for about $50 a pound on a cost basis of around $25 a pound. When Krupp . . . and General Electric . . . got control of the patents, the price went up to $450 a pound with a descending cost curve at somewhere around $12 to $15 a pound. After the Department of Justice moved in, the price came down to about $40 . . . which still shows a handsome profit."

all the large cities. In these markets there is usually a large cooperative organization of producers negotiating the prices to be paid members by the dealers and distributors in that market. Where the cooperative controls a large portion of the supply, it may be difficult for outsiders to find a purchaser for their milk even though they might be willing to sell at lower prices. Various devices may be used to make it difficult to become a member of the cooperative. It is also alleged that in a number of markets the health departments have refused to inspect the farms and herds of new producers who desire to sell in the market. Where the ordinances require inspection, this proves an effective method of exclusion. More formal controls have been instituted in a number of markets in states having milk-control boards, and in a smaller number of markets in which there is considerable interstate commerce, by orders from the Secretary of Agriculture of the United States. In most of these there are provisions allowing restriction of free entry to the market.

The Agricultural Act of 1948 makes provision for marketing quotas on five important agricultural commodities. The conditions under which the quotas may be established are specified for the individual commodities by the Act. A referendum of the farmers subject to this quota must be held, and the quota will be in force unless more than one-third of those voting are against it. In years in which quotas are voted, commodity loans by the government are to be available on these products within certain ranges of a calculated parity price. Prices will thus tend to be higher in years in which these provisions are utilized.

At the present time, a major fallacy seems to permeate our thought concerning monopolies. Each group regards its problem from its own individual viewpoint and appears to believe that it may improve its relative position by a smaller output sold at higher prices. Thus the labor group through its unions demands a higher wage per unit of time and shorter hours, the farm group favors proposals designed to curtail production, and businessmen endeavor to establish sheltered markets through advertising or exclusion of competitors. In cases where elasticity of demand and cost reductions are favorable, an individual group restriction will improve the relative position of that group, but undertaken over a broad range the effect must be detrimental because it reduces the total volume of production and the gain made by one group is made at the expense of others. The increasing growth of monopolistic activity in our society should be a matter of

grave concern to the consumer, particularly when supported by legal sanction. The extension of monopolies cannot fail seriously to influence the level of consumption of the people as a whole.

Questions

1. The barbers in Minnesota secured a law authorizing them to agree on a price for haircuts; if two-thirds of a community agreed on this price, all shops would be forced to charge at least as much. Is such a law desirable?

2. Would the public be better off with a large number of small partial monopolies or a few larger ones, *e.g.*, more Standard Oil companies or a few larger ones?

3. It is sometimes argued that in the case of exhaustible resources monopolies are desirable. Why might this be so?

4. A number of years ago, when Old Golds were introduced on the market, $5,000,000 was set aside for advertising. Do you think the public gained from the introduction of this new brand into the field? Would they have done well to support it, or should they have continued to buy the old brands?

5. In a monopolized industry, say a milk market, would it make any difference to consumers if the laborers organized as a monopoly—*i.e.*, would labor monopoly operate simply to divide the monopoly profits, or would it increase prices to consumers as well?

6. Are there any reasons for supposing that agreements among farmers to restrict sales are not so dangerous to consumers as agreements in other fields?

7. A real estate company in Los Angeles has control of one of the more desirable residential districts. Though there is an overplus of residential building lots in most sections of the city, the tendency seems to be to move into the section controlled by this one company. Is there likely to be any element of monopoly in the price of the lots sold by the controlling company? If so, how much?

8. What is the fundamental difference in the relationship between price and production under perfect and nonperfect competitive conditions?

9. Considering the existence of potential and indirect competition, are there any circumstances under which monopoly can long flourish?

10. From a reading of Arthur Burns' "The Decline of Competition" would you say that the evidence presented proves the thesis suggested by the title? Support your answer with actual case material.

11. Agricultural and labor are in effect excused from the rigors of the antitrust laws. Utilizing the Index to Legal Periodicals for sources of data, write a paper either on "Agriculture and the Antitrust Laws" or "Labor and the Antitrust Laws," indicating (*a*) the basis upon which the particular activity is treated differently, and (*b*) the extent, if any, to which the activity does come within the scope of such laws.

12. Write a paper on the patent laws and antitrust legislation, pointing out the limits placed on patent holders by our antimonopoly measures, but pointing out also the amendments which seem to be required, if any, to protect the public interest.

13. There have appeared from time to time in the economic journals—*The Quarterly Journal of Economics*, *The American Economic Review*, and *The Journal of Political Economy*—discussions of the various possible tests of the existence of

monopoly in a business or industry. On a basis of these materials write a short critical paper on tests for determining the extent of monopoly power.

14. Write a critical review of Thurman W. Arnold's "The Bottlenecks of Business" or Wendel Berge's "Cartels—Challenge to a Free World."

15. Write a paper on the actual methods utilized by the Department of Justice in antitrust law enforcement, based on a study of TNEC Monographs Nos. 16 and 38.

16. Discuss critically Sec. 2 of the Clayton Act (Robinson-Patman Amendment) as an antidiscrimination measure. Is this legislation in the consumer interest? Explain.

17. Is price discrimination necessarily an evil practice? How about doctors charging the impecunious a lower fee? Children being admitted at a lower price to a baseball game or a movie? Explain.

18. Distinguish between price and nonprice competition.

19. Some prices are set by the seller, some by the buyer and some by negotiation between the two. Give an example or two of each situation.

20. What is meant by the statement that merchandise was made to sell at a particular price.

21. Discuss the price policy of (*a*) a wheat farmer, (*b*) United States Steel Corporation, (*c*) Sears, Roebuck and Company, and (*d*) your corner druggist.

CHAPTER VII

CONSUMER PROTECTION

The economic organization of society around a system of prices permits exploitation of the consumer in two general ways: (1) when, as has already been pointed out, the supply of a particular good is principally in the hands of a powerful group, and a monopolistic or quasi-monopolistic price is exacted; and (2) when the consumers themselves are unable to judge the character of the goods that they are buying. The situation regarding the consumer is quite different now from what it was 100 years ago. For one thing, there are now many more goods from which to choose; hence intelligent choices are more difficult to make than heretofore. Moreover, goods are now made in so many grades to accommodate the varying standards of living that one is hard put to it to distinguish properly between the several grades offered. In addition, the purchaser no longer is acquainted with the seller and thus cannot rely so much upon his integrity. Consequently, the purchaser to a great extent depends upon the unsupported claims of the vendors for his information about the commodities and services purchased. As a result of these and other factors, we have in the United States what has been referred to earlier as a dual system of control. Competition is still the basis of our economic society, but governmental supervision of many activities in the market place has been substituted for complete freedom of enterprise.

In order to decide whether the consumer is *adequately* protected, one must first find out to what *extent* he is protected. But first let us summarize the more specific ways in which the consumer *may* be adversely affected in our present economy:

1. The consumer may become the victim of a sales idea and make an important purchase on the basis of it. Example: The Octane selector advertised by certain automobile companies a few years ago was nothing more than a spark lever, but since a spark lever possessed no sales appeal the device was given this important-sounding name.

2. The consumer may purchase an article for which, because of a monopolistic situation or because of his own ignorance, he is charged an inordinately high price. Example: Bayer's aspirin, though little if

at all different from any other acetylsalicylic acid, is often priced five times as high as the lowest priced aspirin.

3. The consumer may be the victim not only of an excessive price, when judged in terms of a sound product, but at times the good or service that he buys is *worthless*. Example: A few years ago Sanatogen was being sold as . . . "a scientific compound every particle of which represents the finest concentrated tissue constructing nutriment . . . [which] . . . contains over 700% more tissue building, life-sustaining nourishment than wheat flour." That this statement was somewhat oversanguine was demonstrated when a laboratory analysis revealed that $1 worth of wheat flour contained as much energy as $197 worth of Sanatogen.

4. The consumer actually ailing might purchase a so-called *cure* possessing only palliative powers and, hence, not discover the limitations of the product until it is too late. This is a particularly fruitful field for the quack because: (*a*) the consumer of this type of product is not in a normal psychological state and is therefore more amenable, and (*b*) many people to whom, say, cancer advertisements might appeal cannot afford expert medical advice.

5. The consumer might be the victim of the purchase of a definitely dangerous product (not only exorbitantly priced, not only worthless, but definitely harmful!). Example: A commodity of this type was LashLure, which when applied caused, in at least one case, total blindness.

1. Protection of the Consumer-buyer by Law. Before mentioning the several specific agencies designed for the purpose of protecting consumers, it seems advisable to review very briefly the law that applies in the sale of merchandise. As will be seen, the consumer-buyer is not without legal protection. He should, however, avoid shady situations and exercise reasonable care in making his bargains so that an invocation of legal remedies will be unnecessary. In other words, although the consumer as a buyer is granted some legal protection, the necessity of resorting to such remedies should be avoided if possible.

Breach of Warranty. "As matters stand, the buyer is armed with all the varieties of remedy known to the law today, and well armed. Let us take the simple case in which a misstatement is made by a seller: the article that was said to be pure silk turns out to be partly artificial silk. However innocently or casually the statement may have been made, and regardless of whether it was oral or in writing, on a label in a printed advertisement or in a radio broadcast; or only by implication, as when the dealer hands the goods to the buyer in response to

the buyer's description of what he wants, without himself saying a word—regardless further of whether the misrepresentation was made by the seller in person or by an employee, and, if made by the latter, regardless of the instructions and cautions given and other precautions taken by the employer to prevent the employee from making misstatements—the buyer can rely in the first instance on the breach of warranty which the Uniform Sales Act in force in the majority of our states reads into the transaction.

"Whatever the law may have been in 1606 as to the distinction between a bare affirmation and a warranty, this is the law today: " 'Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon.' "

There are also liberal implied contracts of correspondence with description, conformity to sample, fitness for particular purposes, merchantability, and compliance with trade usages and customs.

To understand the tremendous meaning of breach of warranty under the Sales Act, let us consider the courses open to the disappointed buyer.

First, he may keep the goods and sue or set off for the breach.

Second, he may regard the warranty as a condition (this is an idea brought into the English act from Scotland and then copied into the American act) and refuse to accept the goods, or if he has accepted them he may return them and refuse to pay or be otherwise bound by the contract, or, if he has paid, he may demand his money back.

Third, if he has suffered damages from the breach of warranty (remember, a 10-cent purchase might conceivably cause thousands of dollars' worth of damages), he can sue for the actual damages reasonably foreseeable, though far in excess of the purchase price.

Fourth, in a proper case he might demand specific performance with the aid of equity, though in the highly simplified illustration used here it is improbable that a court of equity would see any reason for intervening, as the remedy at law seems adequate.

In the face of such a drastic law of warranty, it is difficult to understand why critics persist in accusing the law of washing its hands and piously saying *caveat emptor*.

Fraud. "If we add one detail to the misrepresentation of the seller of the artificial silk, namely, what the lawyers call *scienter*—the knowledge that the statement was false or a reckless disregard of its truth or falsity—we have a case of fraud. Fraud opens many possibilities for

redress. There is the tort action for deceit. There is a possibility of criminal proceedings for obtaining money under false pretenses, or whatever the crime happens to be called in any particular state. In fact, many crimes are built on fraud, false advertising, misuse of the mails, misbranding, or exposing for sale without some notice that may be required by statute—more likely to be found in the case of such foodstuffs as oleomargarine than in the case of cloth. Details are statutory, but the general principle is practically universal. . . .

"[It must be admitted however that] fraud is hard to detect and harder still to prove. The law wisely refrains from giving it an exact definition, for that would be the signal for tricksters to exercise their misguided ingenuity. When fraud is relied upon for the setting in motion of criminal law, the whole procedure, particularly the mode of proof, becomes darkened by the long tradition of the presumption of innocence. Even in civil proceedings, from the very nature of the case we must anticipate difficulty in uncovering fraud, for it is the essence of fraud to conceal fraud. . . .

"Finally, the cost and the trouble of fighting such a case for the small transactions of the consumer are prohibitive. The reputable dealer is likely to take the stand that the customer is always right, and the disreputable dealer is likely to escape altogether."[1]

As we shall see later, however, specific governmental agencies—the U.S. Post Office Department, the U.S. Food and Drug Administration, and others—organize their efforts in the direction of controlling fraudulent activities. Through such agencies fraud can be more effectively dealt with than is possible by private suit.

2. Protection of the Consumer from "Unfair" Prices. One way that the consumer may be harmed is through excessive prices. The prices charged by the monopoly are generally higher than those which would have obtained had competitive conditions existed in the industry, and in consequence some control is desirable.

There are in general four courses open to government in facing the monopoly problem: (1) Monopolies may be "let alone"—as is done in some European countries—on the assumption that competition will, in time, take care of the situation. (2) They may be destroyed and unfair practices tending toward monopoly proscribed. (3) They may be tolerated but regulated (on the grounds that it is to the consumer's advantage, since in some types of industries costs decline as

[1] Quoted without footnotes from Nathan Isaacs' excellent article, The Consumer at Law, *Ann. Am. Acad. Political and Social Science*, vol. 173, pp. 180–182, May, 1934.

volume increases). (4) They may be taken over entirely by the government as publicly owned and managed enterprises.

We have in the United States utilized each of the last three policies in our attempt to handle the monopoly problem. In other words, under some circumstances we in the United States have tried to make competition mandatory by forcing monopolies from the field; in others, we have recognized the social advantage of allowing a regulated monopolization of the field; in still others (only a few, to be sure), we have retained control of a field, declaring the activity to be a government monopoly. Our method has been *chiefly* that of attempting to maintain competition, however.

Antitrust Legislation. The method of indirect control consists of the prevention of combinations, the dissolution of "combines" already in existence, and the maintenance of the conditions of fair competition by the prevention of unfair business practices. As long ago as 1890, the Sherman Antitrust Act was passed, forbidding, in the field of interstate commerce, all contracts, combinations, or conspiracies in restraint of trade and all monopolies or attempts to monopolize. This type of legislation was strengthened somewhat in 1914 by the passage of the Clayton Act and the Federal Trade Commission Act.

The Sherman Antitrust Act as now interpreted by the courts takes into account the famous Rule of Reason, and hence the language of the act is modified to that extent. In other words, the Supreme Court came to the conclusion in 1911 that monopolies were not necessarily bad; that, in fact, some monopolies had gained control of the market not by unfair means but by producing a superior commodity or service. The court, therefore, distinguished between "good" and "bad" trusts, *i.e.*, those which achieved dominance through superior management or the good reputation of a superior product as opposed to those which gained their position through exploitation of the consumer or of labor or through unfair competitive tactics. If the monopoly is good, argued the court, there is no reason for dissolution unless it subsequently exerts the monopolistic power that it gains. On the other hand, if the monopoly is bad, it should be dissolved or at least its monopolistic influence should be circumscribed. Though mere size in itself is not considered inimical to public interest, the court has warned the large companies that they must be doubly careful lest they utilize their strength unfairly.

The chief instances of outright dissolution by the courts have been in the cases of the Standard Oil Company and the American Tobacco

Company. The Standard Oil Company was simply broken up into a number of similar concerns in which those having stock of the holding company received shares, but in later cases greater efforts have been made to see that the stock was put in the hands of really separate groups. *Consent decrees* have been more numerous than judicial dissolutions. Examples of these are the case of the International Harvester Company, in which the company agreed to amend its policy by selling certain of its lines to independent groups, and the packers' case, in which the five largest packers consented to divest themselves of the ownership of any public stockyards, market companies, stockyard-terminal railroads, stockyard-market newspapers, or public cold-storage warehouses that they owned (except where essential for their meat business) and agreed not to engage in the distribution of certain foodstuffs not directly connected with the business of meat packing.

There seems to be some tendency on the part of the government of late to condone the activities of business entities regardless of size while condemning cooperative action by several separate units. "In recent years [for example], not a single case is on record where an actually functioning business merger has been dissolved".[1] On the other hand, agreements by several on price matters have been condemned regardless of whether the form of organization was the gentleman's agreement, the trustee trust, the pool, or what not.

In general, then, the antitrust laws forbid a group of individuals to act in concert with respect to price matters. This applies to trade-association groups as well as to informal groups of large industrialists. Thus, in the so-called Hardwood (1921), Linseed (1923), and Trenton Pottery (1927) cases the courts condemned schemes which had as their purpose a restriction of production and a fixing or maintenance of prices and have taken this stand regardless of the reasonableness of prices so fixed. This principle was reaffirmed in the Sugar Institute case (1936) when it was decided that an open-price plan was illegal if accompanied by agreements not to deviate from reported prices. On the other hand, in the Maple Flooring (1925) and Cement (1925) cases the courts condoned the exchanging of past cost data in an absence of agreement regarding prices. And, in addition, in the Appalachian Coal case (1933) they tentatively whitewashed a cooperatively operated sales agency in an absence of monopolistic control.

The courts, then, seem not to condemn associational activities

[1] Willard L. Thorp, Government Regulation of Enterprise, pp. 701–702, in W. E. Spahr and others, "Economic Principles and Problems," 3d. ed., vol. II.

which tend to raise the level of competition. Thus, they allow the gathering and dissemination of credit information although, presumably, they would condemn concerted action in granting or refusing credit to individual applicants. They also allow group action in advertising the product of an industry, but in general would refuse to condone the establishment of a uniform price for the product. Moreover, trade-associational effort may be expended legally in regard to standardization and simplification, commercial and industrial research, the exchanging of information in traffic matters, the handling of disputes by means of commercial arbitration, and the improvement of trade-practice standards. Cooperative buying may also be practiced but might become illegal if monopsony power were exerted.

The status of agricultural cooperatives in regard to antitrust matters is somewhat different. The Clayton Act of 1914 provided that antitrust laws were not to be construed as prohibiting the formation and operation of nonstock, nonprofit agricultural associations. The Capper-Volstead Act of 1922, though perhaps not completely clear constitutionally, goes further. In effect, it excuses such associations from some of the rigors of the antitrust statutes by legalizing market operations by agricultural associations provided that either (1) no member is given more than one vote or (2) the association pays dividends of not more than 8 per cent per annum. However, the law prohibits monopolistic control, the result of which is to enhance prices unduly. In fact, in such cases the Secretary of Agriculture is instructed to issue orders to cease and desist; if necessary, petition the district court to enforce his order; and finally, where such action is required, place the matter in the hands of the Department of Justice. Thus, there seems to be some contrast in the application of antitrust laws to agricultural and to industrial groups. This contrasting treatment, no doubt, rests on an assumption of a fundamental difference between the "small impotent farmer" and the "large powerful industrialist." In one, presumably, cooperative action is socially beneficial; in the other it tends to be monopolistic—thus harmful.

The Federal government took some interest before the war in the control of rackets. Racketeering activities have most often been carried on through trade associations controlled by unprincipled gangsters whose purpose has been to gouge legitimate businessmen and hence the public. Much of this racketeering has been centered in New York City. Through the invocation of Federal laws requiring registration of certain types of firearms and through the antitrust statutes, the Federal income-tax law, and the Antiracketeering Stat-

ute,[1] the situation has been cleaned up considerably. Much of the credit for the success of the government in this drive is due to the ingenious gathering of evidence and the administration of the several existing laws by former District Attorney, now Governor Thomas E. Dewey of New York.

Ever since the enactment of the Clayton and Federal Trade Commission legislation, there has been a growing endeavor to control unfair trade practices that *tend* toward monopoly. As will be seen later, unfair trade practices include: (1) cutting prices below cost in a locality in which competition appears; (2) discriminating in favor of merchants who agree to discriminate against competitors' products or to refuse to handle them; and (3) producing special ("fighting") brands, sold at very low prices for the purpose of driving competitors' products out of the market. The use of threats or other forms of intimidation and the employment of spies to ascertain the details of competitors' business transactions are also considered inimical to public welfare since they may lead ultimately to price control.

Public-utility Regulation. The difficulty in the control of public utilities lies principally in the determination of the precise rate to be set for the service offered. The rate should not be set too high, since the consumers would in that case pay more than would be necessary for the services rendered. If, on the other hand, the rate were set too low, the earnings of the company would be small and its capital inadequate, enterprise would be discouraged, and the service and equipment would become dissipated. Such an error might result in an actual confiscation of capital and in the long run would be disadvantageous to the consumer. The goal that is aimed at under this type of control, then, is the setting of a *normal* price, a price based upon cost of production.

The price should be such as would yield competitive earnings for the type of enterprise in question. Quite obviously, this is a difficult price to determine. It involves the determination not only of the rate of earnings but also of the amount of capital upon which the rate is to be based, both of which are controversial matters. It involves in addition the determination of total operating costs, a

[1] The popular name of the statute enacted by Congress, June 18, 1934, which, though exempting labor unions, proscribes the obtaining of money through the use of force, violence, threats, or coercion, the obtaining of the property of another with his consent if induced by wrongful use of force or fear, or the committing of acts of physical violence to person or property in furtherance of either of the foregoing schemes, if such activities affect interstate commerce (18 USCA, 420*a*–420*e*).

figure somewhat more ponderable. In determining the rate base, the market value of the concern cannot be taken, since the market value of any business is the present worth of its anticipated earnings at the competitive rate of interest and the earnings quite obviously depend upon the rates that the business is allowed to charge. Capital value for purposes of rate control is thus quite different from capital value for other purposes, say taxation. It must, in some way, then, have reference to the amount of money invested in the past. This is almost impossible to obtain in established businesses, since the capital may have been watered and the books manipulated in such a way as to disguise the real facts. It is customary, in consequence, to take either the estimated *cost of reproduction* of the plant or a value ascertained by a direct physical valuation and add to this a more or less arbitrary allowance for investments, for good will, promotion expenses, patent rights, etc.

Rates are usually established by public authority, but the final decision as to the reasonableness of a rate rests with the courts. There are several government commissions that deal with things coming within their power. The Interstate Commerce Commission, for example, regulates the rates to be charged by the railroads in interstate business. The Federal Power Commission has to do with interstate nonaffiliated operating power companies. The Federal Communications Commission has control over interstate telephone and telegraph companies. In addition, each state has commissions that perform similar functions for matters lying entirely within the state.

By a system of holding companies, a relatively few management groups have in the past been able to organize and control their public-utility properties to their own advantage. Through purchases (at arbitrary prices) from nonoperating affiliates and through other charges levied upon subsidiaries—for management, engineering, accounting, and legal services—operating costs have been inflated. In addition, holding companies have frequently acquired new property from corporate insiders at inordinately high prices.[1]

It was for the purpose of controlling such questionable practices that the Public Utility Act came into being in 1935. This was con-

[1] The following is a more specific listing of holding-company practices that have been criticized ("Owens on Business Organization and Combination," p. 463): "(1) Loading the fixed capital account of operating utilities with arbitrary amounts in order to establish a base for excessive rates. (2) Engaging in transactions for the purchase or sale of property or securities with controlled or subsidiary companies for the purpose of recording arbitrary profits or fixing valua-

sidered to be a Federal matter since holding companies sell securities in interstate trade, since their subsidiaries sell gas and electricity in interstate channels, and since their contracts are made through the mails. In any case, their activities extend over the several states and cannot be controlled by the laws of any one state.

Originally those drafting the bill contemplated the actual elimination of holding companies by Jan. 1, 1940, but the final draft—the one enacted into law—was not nearly so drastic. According to the law, the SEC is given wide powers of supervision and control, some of which are preventive and some remedial. Periodical reports must be rendered to the commission, making possible such control. On the preventive side—unless it is purely an intrastate transaction—it is necessary, for a holding company to acquire an interest in an operating company, to receive permission from the commission. The commission may refuse such permission if it feels that a concentration of control will be detrimental to public interest. On the remedial side, the commission is authorized (among other things) to (1) establish regulations regarding the payment of dividends by operating companies to holding companies and (2) establish regulations concerning construction and other contracts existing between the affiliated companies. Each of the several powers granted the commission is to ensure that purchasers of service are not charged exorbitant prices and that holders of operating-company securities are given a fair return on their investment. Neither of these ends is accomplished when a small group of men operate the affairs of their companies to their own selfish ends. This legislation, therefore, is admirable in its purpose.

The establishment of prices by governmental authority takes place only in industries of a monopolistic nature. The interests of the consumers of other products or services are assumed to be sufficiently protected under the operation of full competition. A regime in which all prices were established by governmental authority would be undesirable. The reason for this should be quite clear. Unless the price established by the government were the same as the competitive price, there would be an excess of product over the amount demanded at that price, or less product would be supplied than

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tions unjustified by market values. (3) Disregard of prudent financing in excessive issues of bonds, imperiling the solvency of the subsidiary and involving excessive charges for interest and commissions. (4) Deceptive methods of dividing earnings as between operating companies and the parent company. (5) Intercompany financing on a basis disadvantageous to the operating company."

buyers wished to buy at that price. In other words, if the established price were lower than the competitive price, consumers would try to buy more of the product than was produced and some would have to go without; if the established price were higher than the competitive price, producers would produce more than could be sold at that price and some of the product would remain unsold. Only under an elaborate, and probably unworkable, system of taxes and bounties would it be possible to set up a regime in which there could conceivably be a better arrangement of prices than under the purely competitive system.

3. Protection against Product Misrepresentation and Inferior Quality. Consumers are often exploited because they lack knowledge of the market or are unable to judge the qualities of goods in relation to their prices. The wide range of the purchases that the consumer is called upon to make and the limited time at his disposal for studying each of these purchases preclude any close knowledge of the prices or qualities of any one of them. Furthermore, many of the differences in the qualities of goods are not directly visible and are revealed only after elaborate tests. Relatively little has been done directly to ensure consumers' adequate knowledge of the proper price for an article. During the First World War lists were prepared of "fair" prices for a considerable number of articles, but this particular activity has been dropped. The consumer must now secure his own information, which he receives principally from the merchants whom he patronizes, from advertisements, or from special agencies of the consumer-research type.

There are a number of instances in which both consumers and producers would gain by a more adequate knowledge on the part of consumers. In the case of seasonal crops, for example, consumers need to be instructed as to the proper time to buy for canning or preserving, or when the crop is particularly low in price or exceptionally high in quality. The dissemination of such information would be mutually advantageous. Some of the large cooperatives and trade associations are taking steps in this direction.

Federal Trade Commission. The most important legal agency in the control of trade practices in the United States is the Federal Trade Commission.[1] Coming into existence in 1914, this quasi-judicial

[1] Other functions of the Commission are: (1) to make investigations at the direction of Congress, the President, the Attorney General, or upon its own initiative; (2) to report facts in regard to alleged violations of the antitrust laws; (3) to prevent discrimination in price and other forms of discrimination in

body was set up not as a consumer-protection agency but as one designated to protect competitors. Recently, however, the act was amended to deal with practices affecting the public.[1] Although the act originally was designed to furnish protection to manufacturers and tradesmen, its administration was even then advantageous to consumers. In other words, the activities of the Commission, by terms of Sec. 5, protected consumers by indirection, since the test as to whether a competitor had been harmed consisted of whether the consumer had been deceived to the disadvantage of the competitor.[2] As a matter of fact, there is some question as to whether the amendment had any substantial practical effect in extending the protection of consumers from vendors using unfair tactics.[3]

Before the existence of the Federal Trade Commission it was possible, for example—therefore, of course, it was a usual practice—to sell imitation linoleum as genuine linoleum because the practice was not directed against any particular competitor and there existed in consequence no sufficient interest to prevent the fraud. Such practices are now, in part at least, suppressed by the action of the Commission.

The Commission has instituted thousands of inquiries since its inception. An appreciation of the method by which the consumer

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violation of the Robinson-Patman Act amending the Clayton Act; (4) to prevent exclusive-dealing contracts, capital-stock acquisitions, and interlocking directorates in violation of the Clayton Act; and (5) to administer the Webb-Pomerene, or Export Trade, Act aimed at promotion of foreign trade by permitting the organization of associations to engage exclusively in export trade.

[1] Approved on Mar. 2, 1938, the Wheeler-Lea Amendment (S. 1077, 75th Cong. 3rd Session) improved procedure and granted new powers to the Commission. The more important provisions of the amending legislation are: (1) broadening the act to deal with unfair practices adversely affecting the public without reference to competition; (2) insertion of a section dealing specifically with "false advertising of foods, drugs, devices, and cosmetics"; (3) improving the method of procedure in the handling of cases; and (4) strengthening the power of the Commission to enforce final "cease and desist" orders by introducing a civil penalty of $5,000 for their violation.

[2] If no competition existed—if monopoly conditions obtained—the Commission could not prove injury. Hence, theoretically at least, in such cases the respondent could continue the practice with impunity. Actually there is practically no such thing as a competitionless situation. A careful reading of the Raladan case, which was supposed to be an example of such a situation, reveals merely that the Commission failed to *prove* competition. See *F.T.C. v. Raladan* 283 U.S. 643 (1931).

[3] See W. F. Brown, The Federal Trade Commission and False Advertising: II, *J. Marketing*, vol. XII, October, 1947, pp. 193–201.

is protected by the Commission's activities is gained from the following list of some of the types of cases handled:

1. Misbranding of commodities with respect to quality, quantity, origin, nature of manufacture, etc.

2. Passing off goods or articles for well or favorably known products of competitors through appropriation or simulation of such competitors' trade names, labels, etc.

3. Selling rebuilt, secondhand, renovated, or old products or articles made from used or secondhand materials as new.

4. Schemes to create the impression in the mind of the prospective customer that he or she is being offered an opportunity to purchase under unusually favorable circumstances when such is not the case. For example:

a. Sales plans in which the seller's usual price is represented to be made available on some pretext for a limited time or to a limited class only.

b. Misleading trade names calculated to create the impression that a dealer is a manufacturer or grower, is selling directly to the consumer, and is passing on the resulting savings.

5. Imitating or using standard containers customarily associated in the mind of the consumer with standard weights or quantities, but selling the public less than such weights or quantities.

6. Giving products misleading names so as to create value in the minds of consumers, *e.g.*, implying falsely that a product

a. Is so named because it was made for the government.

b. Is made in or came from some locality famous for the quality of such products.

c. Was made by some favorably known process when, in fact, it was made only in imitation of such process.

7. Selling below cost with the intent and effect of hindering, stifling, or suppressing competition.

8. Giving products a purported unique status of special merit through misleading and ill-founded scientific tests.[1]

[1] Federal Trade Commission, "Annual Report," 1936, pp. 67–71. It might be well to mention a few cases specifically in order that the student may have more firmly in mind the type of protection that has been afforded the consumer by the Federal Trade Commission: (1) A hosiery company was selling cotton goods under such labels as *men's merino, gray wool,* and other similar terms. An order by the Commission to cease and desist the practice was upheld by the courts, since such deceptions tend to injure competitors. Obviously, however, the consumer was protected by indirection. (2) A company selling aspirin in advertising its product not only exaggerated the benefits of its product, according

The Commission usually does not enter a complaint of its own initiative but generally awaits a protest by an interested party. Protests are nearly always from competitors, since they are the only ones who are likely to find it worth while to incur the trouble and expense of making a complaint. If the practice is one that injures the consumer alone, and that the bulk of the trade indulges in, the practice may continue indefinitely before coming to the attention of the Commission. After a complaint has been filed, the Commission proceeds much like a court. Evidence bearing on the claims made for the article—its performance and composition—is presented and passed upon. The Commission then hands down its decision based upon the majority vote of its members. The particular dealer is either ordered to cease and desist from the particular practice or, if the Commission does not find against him, is permitted to continue that practice. As a usual thing, decisions, together with the report of any scientific investigations made, are published. Recently there seems to be an increasing tendency on the part of the Commission to deal quietly with the offending firms and to entertain stipulations or agreements on the part of respondents that they will cease unfair practices.

Through its trade-practice-conference procedure, the Commission may entertain rules of fair competition for an entire industry. The rules adopted are of two types: (1) those which have to do with unfair practices and hence, when approved by the Commission, are enforceable through court action, and (2) those which are concerned only with unethical practices and are thus enforceable only through cooperation of the group.

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to the Commission, but attempted to induce the belief that aspirin sold by other manufacturers was not genuine and even implied that the competitors' product might be dangerous. Considering the fact that aspirin is only acetylsalicylic acid and that there are few differences except in price between the various vendors' brands, both implications were unwarranted. The complaint, of course, was made on the basis of injury to competitor, but the consumer was protected as well. (3) Automobile finance companies were advertising their services in such a way as to give the public the distinct impression that the cost of financing through these concerns amounted to only 6 per cent simple interest. The fact is, however, that as in all instances of automobile financing the 6 per cent was discounted, which meant that the effective interest paid by the customers of these concerns amounted to almost twice that amount. Again the Commission frowned on the practice and asked for stipulations, on the same grounds that customers were deceived to the disadvantage of the companies' competitors. Again the consumer was given protection.

One of the most interesting of the recent groups of rules is that emerging from a conference on the rayon industry. In this the Commission went further than usual in its conference procedure by promulgating rules concerning the wording used in the advertising of the product. Thus, Rule I declares it to be unfair trade practice to represent or sell rayon as "(1) not being rayon; or (2) as being something other than rayon." Indeed, a positive statement that a rayon product or material actually is rayon must be made clearly on the label and in the advertising and sales promotional material.

Rules were also promulgated by the Commission for the fur industry.[1] These rules cover in great detail labeling, advertising, and merchandising practices and make it mandatory to use correct names in describing furs, to avoid the term *genuine* except where actually appropriate, and to eschew misleading and fictitious pricing practices. Similar rules may be expected for other industrial groups as time goes on.

Even before the Wheeler-Lea Amendment, the Commission instituted a system to control more effectively the publishing and dissemination of untruthful advertising matter by individual firms. In 1929 a special board of three members was set up for this purpose by the Federal Trade Commission. With the purpose of reducing false and misleading statements to a minimum, this board reviews all advertising matter published in newspapers and magazines and broadcasted over the radio. To this end the board examined 96,939 advertisements and noted 9,074 as containing statements appearing to be false or misleading during the year 1935–1936. These 9,074 advertisements formed the basis of 1,865 prospective complaints. During the same year the board received copies of 337,443 commercial broadcasts by radio stations of which 19,572 were marked as representations appearing to be false or misleading. Of these, 1,304 became cases for further review and procedure in instances that appeared to require it.

The procedure in such cases is as follows: If a periodical or radio advertisement appears to be misleading, the Commission sends a questionnaire to the advertiser requesting a sample of his product, a quantitative formula, and copies of all advertisements published during the year. Upon receipt of these data, the claims, sample, and formula are sent to one of the technical agencies of the government for scientific opinion. If the advertiser is proved to be justified in

[1] Copies of trade-practice-conference rules may usually be had on request from the Federal Trade Commission.

his claims, the case is tentatively closed; if not, he may enter a stipulation or be asked to cease and desist. In the latter instance, the case may finally have to be settled in the courts. The Commission is of the definite opinion, probably justified, that its work in this field has contributed to the general improvement in the character of advertising manifested in the last few years.

All the foregoing activity with respect to untruthful advertising has been carried on through general Commission powers. The Wheeler-Lea Amendment gives the Commission specific powers for controlling false claims. It is now declared unlawful to disseminate false advertising through the mails, in commerce, or by any other means, for the purpose of inducing the purchase of food, drugs, devices, and cosmetics. False advertising is defined as that which is misleading in a material respect. The definition includes not only acts of commission but acts of omission also. That is to say, not only are affirmative false statements punishable but the failure to reveal material facts as well.

As to the effect of the new sections upon industry and the consumer: according to the law, whenever an advertiser publicizes an offering of food, drugs, devices, or cosmetics, the advertisement must contain no false statements and must not fail to disclose facts material to the consequences that may result from the commodity's use. Moreover, no retailer may, in the future, rely upon the statement or assurance of the manufacturer of an article; exact and scientific knowledge is required. Since, in addition to the specific proscriptions, better enforcement procedure has been provided, this legislation is an important step toward more effective consumer protection.

Pure Food and Drug Laws. The Federal government makes an attempt to protect the consumer in his purchases of food and drugs by means of the Food, Drug and Cosmetic Act, the Meat Inspection Law, and various acts standardizing containers, weights, and measures. As in the case of legislation dealing with monopolies and unfair trade practices the Federal laws deal only with articles handled in interstate commerce. There are in all states, as we shall see, pure food laws more or less like the Federal law, and in addition many municipalities regulate certain articles through their ordinances.

The present Food, Drug and Cosmetic Act became effective Jan. 1, 1940.[1] It prohibits interstate and foreign commerce in adulterated and misbranded foods, drugs, and therapeutic devices. The Act

[1] An interesting history of the developments in the United States is Stephen Wilson's "Food and Drug Regulation," American Council on Public Affairs, 1942.

authorizes the establishment of definitions and standards of identity and standards of quality and fill of container for all except a few foods. Comprehensive definitions of adulteration and misbranding are set up for the effective control of actual and potential abuses of consumer welfare. These standards are established after extensive study and public hearings with respect to the commodity. Drugs sold as official drugs must comply with official requirements or standards or may differ from these requirements if the differences are stated on the label. The official requirements or standards are contained in these compendiums recognized by the Act, namely, the United States Pharmacopoeia, the Homeopathic Pharmacopoeia of the United States, and the National Formulary.

A drug is misbranded if the label is false or misleading in any particular. It is also misbranded if it is dangerous to health when used as prescribed on the label; it is likewise misbranded when it fails to bear certain statements where appropriate. For example: (1) Package drugs must bear the name and address of their manufacturer or distributor, and the statement of quantity must be readable. (2) The statement "Warning—may be habit-forming" must appear on packages containing narcotic or hypnotic substances. (3) Unofficial drugs must bear their common or usual name, and such compounds must contain the names of active ingredients. (4) All drug labels must bear adequate directions for use and adequate warnings against misuse. The section of the act on new drugs prohibits their introduction until an application has been filed with the Administrator of the Federal Security Agency and has become effective.[1] Drugs that the Administrator finds unsafe for use under conditions as prescribed are prohibited from being shipped in interstate commerce.[2]

There is also provision in the Act relative to cautionary labeling of coal-tar hair dyes. According to the law, such a product must bear on its label: "Caution—this product contains ingredients which may cause skin irritations on certain individuals and a preliminary test

[1] Each application will become effective on the sixtieth day after filing unless the Administrator postpones the effective date. The provision in effect requires proof of safety in use as a prerequisite to the introduction of new drugs, thus precluding a repetition of the famous "Elixir Sulphanilamide" blunder of 10 years ago which took over 70 lives.

[2] The Act was amended in February, 1942, to prohibit the distribution of insulin containing drugs that have not been certified and to regulate the labeling of such products—a move which became desirable with the expiration of the original patents held by the University of Toronto on the manufacture of insulin.

according to accompanying directions should first be made. This product must not be used for dyeing the eyelashes or eyebrows; to do so may cause blindness." Moreover, the legislation provides that germicides must actually possess germicidal powers. This would seem to be a very reasonable provision, but before passage of the act certain so-called *germicides* did not have such powers. Indeed, the administration found some preparations in which germs were actually propagating!

The shipment of all foods injurious to health is prohibited. In cases where it is necessary to add poisons (*e.g.*, with some sorts of spray), definite provision may be made for the extent of tolerance. In addition, labels on food (except butter, cheese, and ice cream) must declare artificial coloring and chemical preservatives; dietary foods must be informatively labeled. Incidentally, confectionery containing trinkets is outlawed under the Act. The measure has been interpreted as outlawing certain types of economic cheating also (particularly prevalent in wartime), such as selling a spurious commodity (*e.g.*, "olive" oil) short-weighting an item by introducing some filler substance, the use of deceptive containers, etc.[1]

The Food and Drug Administration has worked under a terrific handicap ever since its inauguration. The job of supervising the food and drugs of a population of 140 million people with a comparatively small staff spreads the efforts very thin. On a per person basis the budget amounts to only a few cents per capita. Nevertheless, with these small funds a remarkable protective work is accomplished, largely, of course, because the bulk of manufacturers wish to comply with the law.[2]

Another piece of legislation leveled at impurity of foods is the Meat Inspection Law (1907). This act provides that meat entering interstate trade be inspected by well-trained veterinary inspectors and that the product be so marked. Hence, the consumer is usually safe in the purchase of meat that is labeled "U.S. Government Inspected." Often state governments have inspection machinery for intrastate supplies, and in many instances all meat going through a packing plant whether for intra- or interstate trade is inspected.

[1] For an excellent summary of the various types of violations handled by the Enforcement Division see "Annual Reports," Food and Drug Administration, 1941–1942, 1942–1943, pp. 7–54.

[2] Information accumulated over the years by the Food and Drug Administration includes pertinent data on more than 50,000 food and drug factories and processing plants which ship merchandise in interstate commerce.

Thus there is another area in which consumer-protection legislation is in effect. Although the consumer is in no sense protected from excessive price by legislation of this type, he is definitely given some measure of protection from dangers arising out of the consumption of harmful food products.

Several other laws having to do with food and drugs might well be mentioned at this point. One—the so-called Haugen Amendment (1923)—provides a statutory definition for butter. This product is defined by law as "the food product usually known as butter, and which is made exclusively from milk or cream or both, with or without common salt, and with or without additional coloring matter. [and containing] . . . not less than 80 per cent by weight of milk fat, all tolerances having been allowed for." In addition we have laws which declare unlawful the importation of adulterated or spurious drugs (1848), impure tea (1883 and 1897), and unhealthy or unwholesome meats (1922). Moreover, horse meat (since 1919) may not be transported unless it is labeled as such. Also an import milk act (1927) exists which provides protection by means of a regulation of milk importation through mandatory inspection and licensing.

Some of the existing food laws exert control through the taxing power of the Federal government. Filled cheese (since 1895) is heavily taxed as is (since 1898) mixed flour. Many of these, while ostensibly consumer-protective, actually are designed to protect industry. For example, the Oleomargarine Act (1886) places a discriminatory tax on colored margarine over white. The consumer-protective aspects of legislation of this type are quite secondary to their producer-protective aspects. There are, however, certain consumer-protective features contained therein. Without legislation, for example, unprincipled producers in the margarine field might actually succeed in selling their product as butter; might at least (if the product were attractive enough in appearance) succeed in charging prices somewhat higher than would be possible otherwise.

Questions

1. Is the present antitrust legislation consumer protective? If not, what should be done in order to make it protective of consumer interests? Can any law be devised in an economy such as ours fully to protect the consumer against prices containing an element of monopoly?

2. What is a racket? Why is the existence of rackets inimical to consumer interest?

3. The National Industrial Conference Board in its book, "Public Regulation of Competitive Practices in Industry," classifies Federal trade regulatory ac-

tivities under three headings: (*a*) Regulation of Price Policies, (*b*) Regulation of Sales Promotional Policies, and (*c*) Regulation of Trade Relation Policies. Write a short essay on governmental regulation of competitive practices on the basis of this classification, utilizing actual case material.

4. On the basis of a study of one or two recent issues of the Federal Trade Commission's "Annual Report," write a brief summary statement concerning (*a*) the provisions and administrations of the Wool Act as a consumer-protective device, or (*b*) trade-practice conferences and consumer protection.

5. What is the relation between the Federal Trade Commission and the Food and Drug Administration as a result of the amendments of 1938?

6. Radio advertisements, when referring to some headache remedy, presumably as a result of Federal Trade Commission activity, must now be careful to avoid claiming curative powers and thus represent only that it is "for relief of simple headaches." Likewise, they must warn prospective buyers of such "remedies" to "take only as directed." To what extent are these regulations actually consumer-protective? Can you think of any better ways of handling the problem?

7. Make a brief study of the attempt of the Federal Trade Commission and the Pure Food and Drug Administration to control slack filling of containers and report on your findings.

CHAPTER VIII

CONSUMER PROTECTION (*Concluded*)

4. Other Federal Agencies. There are many other types of consumer-protective legislation designed to protect quality, which should be mentioned. Some of this legislation is of the general type protecting consumers from fraudulent enterprises of all kinds. Most, however, is for the purpose of protecting consumers in the purchase of specific types of goods and services. Each should be given some attention by the student of consumption economics in order to see just what exists in the way of legal protection.

Postal Department. One of the most important of the existing consumer-protective legislative devices is the power of the postal service to control the use of the mails. Thus, the department is legally charged with the responsibility of proscribing the use of the mails in connection with fraudulent enterprises. This legislation is administered through the Inspection Division and Solicitor of the U.S. Post Office Department. The legislation covering this phase of consumer-protective activity is very broad indeed. The use of mails in direct connection with a fraudulent scheme (*i.e.*, the mailing of the article purchased, by the vendor) is not necessary in order that a vendor be involved. The section is more broadly interpreted to mean that the use of the mails *in the furtherance of* or *in connection with* any fraudulent enterprise is in violation of the law.

"It is entirely safe to say that every day witnesses the abstraction from the pockets of our citizens of far more money by the use of cunningly devised printed statements than is removed at the point of a gun or by threats of bodily harm. Complete statistics are not available, but it is a matter of record that in only 97 of the 3,643 mail-fraud cases investigated in the fiscal year 1936, more than $36,000,000 was filched from the victims of the schemes.[1] An examination of the palpably fraudulent schemes currently being advertised in the columns of magazines and periodicals enjoying a

[1] Such activities include failure to furnish merchandise as promised, sale of worthless or deceptively worded insurance policies, sale of worthless securities, mythical estates, "work-at-home" schemes, fake cures, etc.

nation-wide circulation will convince the most skeptical that enough is not yet being done under the mail-fraud statutes to protect the uninformed and the unwary. . . . The Post Office Department cannot be said to be performing its full duty to the citizen until it takes cognizance of such advertisements and suppresses such fraudulent schemes before the pockets of the swindlers have become filled with the savings of their victims."[1] The department brings the full force of the mail-fraud statutes to bear upon racketeers and other swindlers who conduct their operations through the mails. A total of 6,252 mail-fraud investigations were authorized during the fiscal year 1937, an increase of more than 35 per cent over the number for 1936. Arrests for fraud during 1937 increased from 824 to 927 and convictions from 563 to 638.[2]

The postal authorities have two ways of handling fraud cases: (1) prosecution through the U.S. Department of Justice on a basis of evidence gathered by postal inspectors, and (2) issuance of a fraud order. Each of these methods is used extensively. The former is somewhat slow, and since speed is essential in many of these cases the method loses much of its effectiveness. The latter is a particularly effective device when speed is necessary. For example, a fraudulent enterprise is started and is receiving a continuous stream of checks from its victims. Prosecution may be resorted to and inevitably will be in time, but meanwhile the money continues to pour in. Citing the individual to appear in Washington within, say, 10 days to show reason why a fraud order should not be issued and the subsequent issuance (in the case of failure legally to justify his activity or in case of failure to appear) of a fraud order quickly deprive him of the use of the mails. All mail addressed to him is marked *fraudulent* and returned to the sender.

[1] "Annual Report of the Postmaster General," pp. 75–76, fiscal year ended June 30, 1936.

[2] As an example of the type of cases handled by the department: Just previous to the opening of the fiscal year 1937 there became very active in many sections of the country a particularly vicious swindle practiced on elderly persons. Securing names of victims both through personal inquiry and from spectacle peddlers who received commissions, two of the swindlers would visit the victim and convince him that he had a cataract that might cause blindness or paralysis. They would fill the eye with argyrol or other solutions and place a piece of thin rubber or skin from the inside of an eggshell on the eye. The rubber or skin would then be taken off and exhibited as proof that the cataract had been removed. For a pretended operation of this kind the swindlers obtained from $50 to $500. The department now feels that this racket has been effectively suppressed. Thirty-five of the bogus eye specialists have been convicted and sentenced to terms of imprisonment totaling 177 years.

One limitation to any scheme designed to protect the consumer against himself is the consumer's own gullibility. One case illustrates the point: A fraud order was issued against a company that was selling fake oil shares. Despite the fact that mail was returned to the senders marked *fraudulent,* many of the victims were annoyed by the interference of the postal authorities and actually circumvented the regulating activities of the department by sending their money to the vendor by wire.

The postal regulation as a consumer-protective device has several additional limitations. For one thing, most of the cases handled by the department originate through complaints. In other words, someone must complain, in most instances, before investigation is made. This limitation, it would seem, should be remedied. There ought to be some agency that actually examines advertising copy. Perhaps there ought to be closer cooperation between the special board (now advertising investigation bureau) of the Federal Trade Commission and the Postal Inspection Unit. This type of cooperation, though practiced in some instances, should be extended. It could be carried on effectively not only between the U.S. Post Office Department and the Federal Trade Commission, but also among several protective agencies, including the SEC and the Pure Food and Drug Administration.

Though it is generally agreed that the mail-fraud statute affords the consumer a great deal of protection, one must admit further limitations. For one thing, the Postal Inspection staff is too small for completely effective work. For another, the U.S. Post Office Department procedure is somewhat inflexible. By the simple process of changing the name of the company disreputable dealers have at times kept one jump ahead of the law. One would imagine that if the postal authorities were impotent in such circumstances, one of the other governmental agencies (the Federal Trade Commission or the Pure Food and Drug Administration, say) would be in a position effectively to act. And often this is the case. Occasionally, however, commercial knaves have been able to circumvent the regulations of all three agencies.

Federal Housing Administration. One of the agencies whose activities are of a consumer-protective nature is the Federal Housing Administration. Inaugurated in June, 1934, for the purpose of inducing recovery, this organization offers very effective protection to the homeowner from the time the lot is selected and the house is planned until it is fully paid for and title is delivered to the purchaser.

When a house is to be built and an application for mortgage insurance is filed with the FHA, through any FHA-approved private-lending institution of the borrower's choice, trained technical experts launch a carefully planned program to safeguard the buyer's interests.

First consideration is given location, to ensure that the house is not in a neighborhood likely to become undesirable in a short time. The entire appraisal system of this governmental agency is based not only upon the present worth of the property, but upon its probable value in future years when it is paid for in full. Attention is given to every feature of the building lot—the neighborhood, surrounding developments, sewage disposal, water supply; electricity, gas, and telephone service; nearness to schools and shopping centers; transportation facilities; and all other features that have a bearing upon the value of the property.

Meanwhile the FHA architectural staff, composed of competent specialists who know what should go into a well-planned, well-constructed house, carefully review the plans and read the specifications to assure practicability of design, livability, and compliance with the government's minimum standards of building. Approval by the architectural staff means that plans, in its opinion, are sound and that specifications call for good building materials.

Few who invest in homes really know whether their houses actually are being built in accordance with the plans and specifications. For instance, few laymen would recognize the difference between green and seasoned lumber, few would know if foundations were properly laid, whether framing is sufficiently strong, whether good-quality building materials are being used, and the thousand other details that make the difference between a good house and a shoddy one. But the purchaser may be reasonably assured that the FHA architectural inspectors will look into such matters. They make periodic inspections of the house during construction to ensure strict compliance with the approved plans and specifications.

Further protection to the purchaser is provided by the FHA mortgage-risk department, which concerns itself with the financial structure behind the house to be built or bought. For this purpose the regular income of the applicant is compared with the proposed investment and the monthly payments that must be met to pay off the insured mortgage. It is considered safe budgeting in most instances when investment in a home does not exceed two and one-half times the annual income and when the monthly payments required to amortize an insured mortgage do not exceed 25 per cent

of the monthly income. In other words, in an average case, an applicant of acceptable credit standing regularly earning $200 a month safely could invest up to $6,000 in a home, establishing sufficient equity so that the payments would not exceed $50 a month, including taxes and insurance. But if he were seeking to build a house out of proportion to income, on which the monthly payments would become an unbearable burden, the applicant would be so advised and mortgage insurance denied on the excessive amount applied for. To protect the purchaser and to safeguard his investment, payments called for on an insured mortgage should not exceed what the applicant safely could budget as rent.

For the individual, probably the greatest safeguard of the FHA insured-mortgage system lies not so much in the strict regulation of interest rates and other charges as in the fair and unbiased valuation system. This is the heart of the FHA insurance plan and offers the consumer protection against exploitation by unreliable builders and unscrupulous lenders. Although the right of real estate brokers and builders to a fair and legitimate profit is thoroughly recognized, the FHA appraisers make a definite attempt to prevent an inflation of values. The purchaser might not be able to detect price inflation, but the careful analysis given the transaction by the FHA's trained experts is a reasonably adequate safeguard against hidden charges and exorbitant profits.

The FHA insured-mortgage system offers many economic advantages. It makes possible not only the lending of a greater percentage of the appraised value of house and lot than under previous conditions, but also the writing of the mortgage for a longer term of years. Thus the purchaser is protected against periodic renewals, with their accumulating fees, bonuses, and commissions. The debt is reduced with the very first payment, and the mortgage is gradually whittled away. The interest and carrying charges, taxes, and fire insurance are included in the fixed installments, which are paid monthly, just as rent is, until the property is free and clear.

Protection to the purchaser by the FHA insured-mortgage system extends even further. Should misfortune overtake the purchaser in the form of loss of income to the extent that he could not conveniently meet the monthly payments, the FHA continues to protect his interest in the property. That is to say, the buyer's equity under such a condition is not necessarily terminated. Should sale of the property become necessary, any amount remaining after the payment of first claims must be returned to the original borrower.

The FHA insured-mortgage system offers the borrower as much protection as it does the lender. Those who build or buy a home under the FHA appraisal system are given reasonable assurance that they are not overcharged or made to pay for value not received. The building plans and specifications must be complete in every detail. A contractor building a home must abide strictly by these specifications. Materials must be precisely of the specified type or quality. The buyer, in other words, is assured of getting the kind of house he has agreed to pay for. From its inauguration in 1934 the Federal Housing Administration has handled over 6 billion dollars' worth of new home mortgages alone; in that same period it transacted a gross business of over 8 billion dollars.[1]

Securities and Exchange Commission. Another area of consumer protection now exists in the field of security selling. Previous to 1933 the purchaser of securities had little specific protection. The consumer, of course, has been protected against fraudulent issues to the extent that vendors have utilized the mails in the furtherance of such schemes. In addition, there are in practically all states "blue-sky" laws whose purpose is to prevent the issuance of worthless bonds and shares. But these were to a large extent ineffective. During the decade following the First World War some fifty billion dollars in new securities were floated; it is estimated that at least half of these proved worthless and many issues were actually fraudulent.[2] Part of the weakness of state laws lies in their poor administration, but part, certainly, results from the fact that security selling transcends state lines.

The sale of securities in interstate commerce is now regulated through the provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934. The SEC was organized on July 6, 1934, to administer the two acts, the former having been previously a function of the Federal Trade Commission. Since its organization the Commission has been charged with the additional responsibility of administering the Public Utility Act of 1935. Thus the supervision of registration of security issues and the suppression of fraudulent practices in the sale of securities, the supervision and regulation of transactions and trading in securities, both on the stock exchanges

[1] Eighth Annual Report of the Federal Housing Administration for the year ending Dec. 31, 1941.

[2] H. L. Purdy, M. L. Lindahl, and W. A. Carter, "Corporate Concentration and Public Policy," p. 134. See also F. Pecora, "Wall Street Under Oath," for a behind-the-scenes view of the securities business in the 1920's.

and in the over-the-counter markets, and the regulation of public-utility holding companies are properly Commission functions.

One of the main purposes of security legislation is that of making it mandatory for investors to be provided with more and sounder information about the character of securities offered. Hence, according to the law, securities cannot be sold in interstate commerce until such information is provided. One of the difficulties the consumer has always experienced in the purchase of securities was the over-enthusiastic representation of the issue by the vendor. Under the existing Federal legislation, all pertinent facts must be truthfully given the SEC by the issuer, these data being used as the basis of a factual prospectus. The prospectus must be made available to prospective security purchasers. Originally, not only the corporation but even accountants and engineers employed by it were held responsible for misrepresentations. Indeed, the liability provisions were so drastic that they were amended somewhat in the 1934 act. In the 6 years from 1935 to 1940 nearly 2,900 registration statements were filed with and approved by the SEC covering a sale of 17 billion dollars' worth of securities.[1] The 1934 legislation has to do mainly with stock-market trading and has many consumer-protective aspects also.[2]

Two points regarding Federal regulation of security issues should be kept well in mind by the consumer. (1) The Commission does not guarantee a security issue. The Commission does not even imply by its approval that it is a sound issue. The Commission merely insists that full and true facts concerning the issue be made available to investors. Even if an issuer of securities were to admit an actual absence of quality in the issue, the Commission, if furnished with full and truthful information, could publicize the facts only; it could not circumscribe the activities of the concern. (2) All securities are not subject to SEC regulation. For example, Federal, state, and municipal bonds; securities of railroads, commercial and savings banks, and building and loan associations are excepted, as well as securities not publicly offered. Moreover, issues of $100,000 or less may be exempted by the Commission.

On securities coming within the Commission's scope, the investor now has a sound basis upon which to judge, however. He may now intelligently choose between a speculative security offering a chance for unusual gains and one that is relatively safe and that offers a

[1] *Ibid.*, p. 141.
[2] *Ibid.*, p. 150.

chance for only small returns. But the purchaser must still use sound judgment. The only difference is that *caveat vendor* now has been substituted for the old *caveat emptor.*

Deposit-insurance Corporations. Closely allied to investment in securities is investment of funds in banks and in building and loan associations. The consumer now is offered a greatly increased measure of protection in this field also. Though banking institutions have been the subject of increased regulatory effort for a century or more, not until recently have deposits been insured by a branch of the Federal government. The Banking Act of 1933 made provision for a temporary and a permanent plan of deposit insurance. Over 14,000 banks in the temporary plan became members of the permanent plan in 1935. The Federal Deposit Insurance Corporation chartered by the Federal government is the guaranteeing institution. Maximum coverage for one depositor in one institution is $5,000.[1] All national banks must be members; most state banks have elected to participate. The Corporation since its inception in 1933 has paid out about 300 million dollars in claims, loans, and purchases of assets; actual losses sustained are calculated to amount to a little less than 35 million dollars.[2]

Probably the most important phase of the deposit-insurance system is the provision for regulating the operations of participating banks. A successful guarantee system requires strict regulatory control of the insured banks. The Federal plan is no exception. Thus the legislation is preventive in the sense that it establishes high operating standards in order to reduce the chances of failure. Regulation covers loan and investment policies, the payment of interest on deposited funds, the carrying of certain types of insurance, etc. In general, participating nonmember state banks are subject to the same supervisory and regulatory requirements as those which are members of the Federal Reserve System, which means that operating policies of participating state banks will, in general, undergo a higher quality of supervisory control than is provided for by the banking codes in their own states.

[1] Although, according to a report of the General Accounting Office of the Federal government to Congress (*Los Angeles Times*, Aug. 18, 1946) "while the insurance to each depositor is limited to $5,000, the corporation's legally authorized practice of making loans to or purchasing assets from merged insured banks in lieu of paying claims to depositors in closed banks results in each depositor being fully protected against loss."

[2] *Ibid.*

In 1934 legislation was enacted, the chief purpose of which was to strengthen the savings and loan association system. Through this act Congress authorized the creation of an insurance plan to guarantee the savings accounts in Federal and participating state building and loan associations. Accounts in building and loan associations are therefore insured by a public concern known as the Federal Savings and Loan Insurance Corporation. Through the insurance of bank as well as building and loan deposits, the consumer is given some measure of protection in still another of his economic activities.

National Bureau of Standards. The National Bureau of Standards, which is a part of the United States Department of Commerce, also carries on activities with respect to standardization. The Bureau establishes Federal specifications which are to apply to goods purchased by the Federal government. For a more limited group of goods, commercial standards have been promulgated. These are originated at the request of groups outside the government and developed by the Bureau with their assistance. Their use is voluntary and their enforcement is outside the government. The Bureau, however, under its Certification Plan prepares lists of firms that are willing to certify to purchasers on request that the goods supplied by them meet the requirements of either Federal Specifications or Commercial Standards.[1] These lists are distributed to tax-supported agencies and to others on request. They are used primarily by large buyers. For the small consumer the Bureau has inaugurated a Labeling Plan. In accordance with this plan, a firm desiring to bring the attention of the consumer to commodities which it is willing to guarantee as complying with the established specifications or standards places labels on the commodity which definitely identify both the specification and the manufacturer or trade association which holds itself responsible for the guaranty. In its work the Bureau establishes only a minimum and leaves unclassified products which are above or below this minimum.

As can readily be seen, Federal legislation of the consumer-protective type extends into many fields. Each type has been presented in such a way as to give the student a survey of its nature and scope. Since an attempt is being made to give a more or less complete account of the important legislation whose purpose or effect is that of protecting consumers in their purchasing transactions, it seems advisable to mention briefly several additional functions of

[1] The TNEC Monograph No. 24, "Consumer Standards," reports that the Certification Plan has already been applied to 666 Federal Specifications and 54 Commercial Standards.

Federal agencies that either directly or indirectly protect the consumer:

1. The control of the advertising and labeling of spirituous liquors, wines, and malt beverages by the U.S. Treasury Department, Federal Alcohol Administration.

2. The regulation of the importation, manufacture, production, compounding, sale, or giving away of narcotics by the U.S. Treasury Department, Bureau of Prohibition.

3. The control of the labeling of caustic poisons by the U.S. Department of Agriculture, Pure Food and Drug Administration.

4. The supervision and control of the sale of biological products as well as of the quality of drinking water on interstate common carriers by the U.S. Treasury Department, Public Health Service.

5. The requiring of the installation of proper safety equipment on American vessels (in order that the consumer be assured of safe passage) by the U.S. Department of Commerce Bureau of Marine Inspection and Navigation.

6. The development of standards of weights and measures by the U.S. Department of Commerce Bureau of Standards.

5. State and Municipal Legislation. State and municipal regulations are accomplished by the governmental exercise of police power. Within a state, the police power may be exercised by the state itself or by the units of local government, such as cities and counties. The extent to which any particular governmental unit may exercise police power must be determined by constitutional and statutory provisions provided for its exercise. Under the California constitution (Art. 11, Sec. 11), for example, all counties and cities may make all local police and sanitary regulations not in conflict with general laws, *i.e.*, not in conflict with statutes passed by the state legislature on the subject. In addition, under constitutional grants of home rule (California Constitution, Art. 11, Secs. 6 and 8), chartered cities have *complete* police power in municipal affairs to the exclusion of the state legislature.

Within their respective spheres, cities, counties, and the state exercise the police power. That is to say, they see to the protection of the health, safety, and morals of the public. Police regulations must be reasonable and, in addition, nondiscriminatory. What is reasonable depends a great deal upon popular belief in and conception of the necessity for such regulation and upon acquiescence, at least, in the type of remedial action provided by a statute. Whether there is such a need is primarily a question for legislative determination. This the courts will not overthrow simply because they doubt the wisdom of the measure. It is only where the court finds that the regulation in

question has no reasonable relation to public health, welfare, and safety that it will strike down a statute on constitutional grounds unless, as was said previously, there is discrimination.

With respect to the nondiscriminatory phase, governmental bodies have a wide discretion in classifying businesses and practices for the purpose of regulation, as long as they bear equally upon all members of a class. The most usual contention set up against the exercise of police powers is that the regulation takes property without due process of law or that it interferes with contractual obligations.

These problems, however, are technical and need not be discussed further in a work of this sort. It will be sufficient for our purposes to indicate the various types of police-power regulation that government —either state or local—has created for safeguarding the purchasing public. These (based upon a law in California) are classified for our purposes as follows:

I. State laws that protect consumers' health:
  A. Pure food and drug regulations
  B. Regulations covering food-dispensing establishments (meat markets, restaurants, etc.)
  C. Meat inspection requirements
  D. Regulations concerning the canning of foods
  E. Milk inspection and pasteurization
  F. Regulations designed to protect watersheds and water supplies from contamination
  G. Quarantining shellfish during certain seasons
  H. Definition of purity of wines
  I. Prohibition of sale of diseased and infected fish
  J. Restriction of the cultivation, sale, possession, distribution, and use of narcotics
  K. Regulation of the manufacture and restriction of the sale of certain types of secondhand goods (regulation of the remaking of mattresses; selling secondhand furniture without fumigating)
  L. Control of the bacteriological count in swimming pools
  M. Prevention of the use of sulphur containing arsenic in the spraying of fruits and vegetables
  N. Regulation of clinics, dispensaries, barbershops, etc.
  O. Prohibition of the advertisement of venereal-disease "cures"
  P. Establishment of professional standards (for chiropodists, chiropractors, cosmetologists, dental hygienists, dentists, midwives, nurses, obstetricians, optometrists, osteopaths, pharmacists, and physicians and surgeons)

II. State laws that provide for the safety of consumers:
  A. Safety to persons
    1. Prohibition of the sale of certain drugs without prescription
    2. Requirement of underwriters' standards in the sale of electrical equipment

3. Bonding of common carriers for the safe transportation of passengers
4. Regulating the sale of poisons
5. Restriction and regulation of building
6. Provision in theaters for proper fire and safety equipment

B. Safety to property

1. Prohibition of frauds
2. Regulation of weights and measures
3. Regulation of insurance companies, state banks, building and loan associations, etc.
4. Prohibition of the issuance of false financial statements
5. Blue-sky legislation; bucket-shop prohibition
6. Requirement for the providing of bonds by warehouses
7. Establishment of standards
   a. Butter
   b. Apple containers
   c. Specific-gravity standards in gasoline
   d. Defining the weight of loaves of bread
   e. Prohibition of the adulteration of paints and varnishes
8. Requirement for labeling
   a. Imported eggs
   b. Commercial feeds; fertilizers
   c. Marking secondhand furniture as such
   d. Statement of *variety* of raisins
   e. Nomenclature of wines

This is by no means a complete listing of state and municipal consumer-protective legislation but should be suggestive in indicating the type of legislation that exists. Both state and local regulations are made and enforced in regard to all of these concerns, as was indicated before. The location of the dividing line between Federal, state, and local authorities depends upon constitutions and statutes.

It might be well, however, briefly to indicate some of the fields in which municipal and county regulation has been employed. The city of Los Angeles, for example, having municipal home rule, has extensive regulations designed to protect the consumer against unsafe building structures and equipment. It prohibits certain types of advertising devices that tend to defraud the public. It regulates auctioneering and the sale of foods and secondhand automobiles (makes vendors register automobiles and put up bonds for the protection of the public in the delivery of the pink slip or title). It licenses baggage carriers and regulates bail-bond brokers, bakeries, restaurants, barbershops, and beauty parlors. To protect the public, it requires bonds to be given by heating contractors, house movers, motorbus and taxicab operators, ticket-sellers, and personal-property brokers. It attempts to control even fire and "come-on" sales.

Smaller cities without home rule, in addition to enforcing existing state law with regard to consumer-protective matters, regulate the sale of food products, prescribe standards for building, regulate the operations of itinerant vendors, etc.

6. Nonlegislative Consumer-protective Agencies. Aside from that of government agencies, there is a growing control being exercised by business itself through the development of codes of ethics.[1] The economic groups that have the most explicit and effective codes are the professions, chiefly the legal and medical groups. Some of the codes established by businessmen are quite effective also, for the organizations behind them are well able to enforce them. Radio broadcasters, for example, operate under a code of ethics that among other things prohibits the broadcasting of "matter which is barred from the mails as fraudulent, deceptive or obscene" and makes it mandatory that "each member station shall refuse any advertising matter regarding products or services injurious to health." So, too, there are codes in scientific research and in the teaching professions, codes for engineers, architects, accountants, and less exact codes for dentists, brokers, advertising agencies, and real estate dealers.

Certain trade associations have taken it upon themselves to indicate certain articles in their field as capable of passing specific tests. For example, the fire underwriters have established a thoroughgoing service, testing and certifying appliances involving fire and casualty hazards. A set of specifications, technical reports, and a regular listing of approved products are maintained. The label "Approved by the Underwriters' Laboratories" implies protection with reasonable certainty, particularly with respect to fire hazard.

There are a considerable number of similar agencies in other lines, but they operate chiefly for industries and little for consumers. There are few examples of such agencies that serve the consumers direct. The Educational Buyers' Association, for example, serves large consumers such as universities, analyzing particular makes of articles and assembling the data and presenting them to their clients so that they may more readily secure the greatest value for their money. Consumers' Research and Consumers' Union, discussed in another chapter, serve the ultimate consumer in somewhat the same capacity.

Certain institutes also are operated, at least nominally, in the interests of the consumer. Organizations like the Good Housekeeping Institute and the New York Herald Tribune Institute usually function by "guaranteeing" the articles advertised in the journals sup-

[1] See J. M. Clark, "Social Control of Business," pp. 223–238.

porting them.[1] *Parents' Magazine* performs a somewhat similar service. These agencies catch the obvious frauds, but that is about all. Very often articles bearing their seal of approval will possess some merit, but one cannot be sure that he is not grossly overcharged for them. Such institutes cannot represent the consumers in an unbiased manner since they derive their subsistence from the advertisers.

Another type of organization carrying on consumer-protective activities is that represented by the American Institute of Laundering. In order to earn the right to utilize this institute's seal of approval, a manufacturer's product must presumably measure up to certain standards of quality, construction, colorfastness, shrinkage, and launderability. If the efforts of the institute are sincere, the results will be advantageous in every direction. For one thing, manufacturers of sound products will be distinguished from those selling shoddy items, and, as a consequence, retail store buyers can more intelligently purchase their requirements. But, what is more to the point, the consumer when requiring first-grade merchandise will be enabled to obtain it. Undoubtedly this is another step in the direction of more effective consumer protection.

The American Medical Association is an example of still another type of consumer-protective organization. "The American Medical Association through its Council on Pharmacy and Chemistry sets up standards for proprietary and unofficial preparations to determine whether or not they are correctly stated. Standards are also established whereby the identity and purity of such products may be deter-

[1] *Good Housekeeping's* guarantee used to read: "This is your guarantee. If you purchase any product advertised in this issue of Good Housekeeping within one year from its date and find the product unsatisfactory, we will carefully investigate your complaint, and if the product is *defective*, it will be replaced or your money refunded [italics ours]." The Federal Trade Commission proceeded against the publishers of *Good Housekeeping* several years ago; in 1941 they were ordered to cease and desist from (among other things) representing directly or indirectly that claims made for products advertised in their periodicals were true when any representation found in such advertisements were not in fact true; authorizing the use of their seal or other insignia indicating that any product had been service-tested unless in fact it had been so tested to assure quality or fulfill claims made for it; authorizing others to represent directly or indirectly that any product or service was guaranteed unless such guarantee was unlimited or unless limitations were conspicuously stated in immediate conjunction with the guarantee. *In the Matter of Hearst Magazines, Inc.*, 32 FTC 1440, 1461–63 (1941). The guarantee now reads (February, 1946): "Each product and service advertised in this issue of Good Housekeeping is guaranteed to this extent: If it is defective or if not as advertised herein, it will upon request and verification of your complaint, be replaced or your money refunded."

mined and controlled. Its publication *New and Non-Official Remedies* describes preparations which the council approves and in addition contains a list of those which it does not sanction. Many articles which are harmful or worthless are exposed in the official journal of the association and its publication *Quacks and Nostrums*."[1]

The American Medical Association also has established standards for satisfactory advertising of foods. When advertising is found to be consistent with the nature of the food, the producer is permitted the use of a label stating that the food is "approved by the American Medical Association." Such approval indicates that consumers can rely on the statements appearing in the advertising. The association publishes the names of accepted products as well as the names of those which have been refused approval on the grounds that the producer was unwilling to change the advertising to meet the standards of the association. This service undoubtedly protects the consumer from merchandise of inferior quality; but, in common with the others previously mentioned, provides little in the way of protection against overpricing.

Considering the fact that much of the criticism leveled at industry has to do with advertising, it is interesting to note the many efforts of businessmen to raise advertising standards. Advertisers are realizing more and more that truthful advertising is helpful to the entire profession. Self-regulative efforts of such organizations as the Advertising Federation of America and the Proprietary Association should be extremely encouraging to the consumer, for they indicate that the businessman himself at least recognizes the need for higher ethical standards in the vending of his wares. And despite the natural bias of such groups, more has been accomplished by them than is generally realized.

The work of the Better Business Bureaus is perhaps one of the best examples of this type of activity. Financed solely through membership support of business firms, including banks, industrial plants, and retail establishments, the bureaus—of which there are about sixty—are expected to:

1. Promote accuracy in advertising through cooperation with advertisers, advertising mediums, and properly constituted authorities.
2. Expose fake promotions and aid in prosecuting fake promoters.
3. Warn the public against endless easy-money schemes.
4. Aid in the elimination of unfair competition.
5. Provide a medium for the settlement of disputes between business concerns and their customers.

[1] Jessie V. Coles, "Standardization of Consumers' Goods," pp. 247–248.

The bureaus' most important weapon is publicity, although prosecution can always be resorted to. Complaints may be made by customers or competitors. The bureaus probably succeed in cleaning up some of the worst of the sales-racket cases (such as permanent "going-out-of-business" sales, "farm-it-by-proxy" propositions, or the sale of cheap machine-made cotton rugs as "genuine Orientals"). The bureaus' slogan regarding investments is advice of the wisest sort: "Before You Invest—Investigate." Hence their work is another link in our consumer-protective system.

7. Standardization and Simplification. It is desirable that the beginnings that have been made in consumer protection be extended much further. Where consumers are unable to judge the qualities of goods, they are open to exploitation in two ways: (1) through the adulteration of products and (2) through the misrepresentation of the powers or services of a particular good by those selling it. The consumer can be protected under such circumstances only by the development of standards, together with their enforcement and a dissemination of knowledge of the precise meaning of the standard in relation to the performance or character of the good concerned. Standards should be worked out from the viewpoint of the consumer, and the labeling of goods in terms of these standards required for as many things as possible. This would not only offer the consumer much-needed protection in the goods that he purchases but would also greatly facilitate the solution of his problem of what to buy and thus ensure a better satisfaction of his wants. It would make it unnecessary for him to be an expert judge of the qualities of many of the products that he purchases. He could, for example, find that a certain grade would fulfill his particular requirements, and he would be able to call for that particular grade or quality without the expert knowledge required to determine whether the article fell into that grade or class. This would result in a great saving of time and effort and leave the consumer more time and energy for recreation or for work in his special field. Moreover, it would eliminate the competitive advantage of the quality cutter and give a greater advantage to the producer who could supply goods of standard quality at the lowest price.

Standardization and grading of consumers' goods has made slow progress because of the complexity of the problem and because it runs counter to important business interests. Manufacturers of high-quality branded articles who have established a reputation for their product do not wish the consumer to discover that there are non-branded or less well-known articles which would be graded in the same class. The value of the brand name would be lessened. Pro-

ducers of low-quality products also object to grading because it would disclose the low quality of the product and increase difficulty of sale. These two factors have been responsible in large part for the violent opposition to consumer grades by certain business groups.

Standardization is not the visionary concept that some people suppose. Indeed, there are many instances of workable standards existing in consumers' goods today. For example, the compilations of standards in medicines of the U.S. Pharmacopoeia and the National Formulary are official and are used as a basis for enforcement of Federal and state food and drug laws.

Another example of standardization in consumers' goods is found in canned goods. Unfortunately, however, this phase of the work has not been carried far enough. Under authority of the McNary-Mapes Amendment, the Pure Food and Drug Administration has begun to set up a series of standards below which no commodity may fall unless it be so marked. The Secretary of Agriculture under this amendment is authorized to promulgate a minimum standard of quality, condition, and fill of container for every class of canned foods except milk and meat products. Brands that fail to meet the standards are required to carry a special label, which for vegetables reads, "Below U.S. Standard, Low Quality but Not Illegal" and for fruits "Below U.S. Standard, Good Food—Not High Grade." Ninety per cent is the standard set for fill of containers. Goods falling below this standard must be marked *slack-filled.* Up to a few years ago, as no money had been appropriated for enforcement of the McNary-Mapes Amendment, grades had been established for only a few items—peas, tomatoes, dried peas, peaches, pears, apricots, cherries, and mushrooms. The Canned Fruit and Vegetable Grading Service of the U.S. Department of Agriculture Bureau of Agricultural Economics also carries on some standardization work. Although it has no authority to enforce standards, the service does have authority to promulgate them and to issue certificates indicating that the goods coincide with those that have been established. Many other government agencies carry on some standardization activities.[1]

Other standards have been established nationally or in various sections of the country for milk, tea, meat products, butter, cheese, ice cream, breads, spices, edible oils, coffee, chocolate, carbonated beverages, etc.[2] One of the most interesting developments along these

[1] See TNEC Monograph No. 24, "Consumer Standards," particularly Chap. II.

[2] For a full and excellent discussion of standardization of consumers' goods, see Coles, *op. cit.*, especially Chap. XIV.

lines is the mandatory grading of meat by municipal ordinance. In the city of Seattle, for example, meat grading is compulsory. The city of New York is considering a similar ordinance.[1] Such a law is definitely consumer-protective since, where it is in effect, the housewife when buying meat not only knows what she is getting but, quality being known, is enabled to purchase what she needs at the store offering the lowest prices.

The Federal government and a number of states have defined the character and size of a number of containers used as measuring devices in the sale of fruits and vegetables. Other standards either exist or are in the process of development in many other lines, including textiles and clothing. Further development of standards, in foods particularly, has been provided for by the Federal pure food and drug legislation.

Standards without a doubt are very important to the consumer. Minimum standards are protective. Various grades resulting from standardization are helpful to the purchaser. It should be recalled that everyone is not interested in buying the highest quality of a product. Grading allows the purchaser to buy precisely the quality required—actually to compare values. But standards need not always be complex. For example, a shirt manufacturer might establish a standard based upon the number of launderings that the material will stand. Thus, shirts may be graded as 30, 40, or 50, indicating the number of launderings they will withstand. In some instances, of course, ultrasimple standards are impossible. In cases of the latter type, consumer education is required. Even where grades of food are actually designated, consumers must learn the meaning of the various designations. This point becomes somewhat clearer when one learns that grades are sometimes identified by such terms as *special, prime,* or *choice* and quite obvious when one considers the confusing grade names selected by some packers. What could be more ridiculous, for example, than the terms selected by olive packers—*medium, large, extra large, mammoth, giant, jumbo,* and *colossal!*—for describing the several grades of their product?

There is also much to be gained from a reduction in the number of varieties of goods that the consumer purchases—*i.e.*, from simplification. An excessive number of varieties of the same product needlessly increases manufacturing costs, retailing expenses, and the difficulties of choice by the consumer. The U.S. Chamber of Commerce estimated at one time that one-quarter of all industrial effort in

[1] *Consumer's Union Repts.*, June, 1938, pp. 6–9.

America is wasted because of irrelevant overdiversification of styles, types, and sizes. Obviously, a world of entire uniformity would be a monotonous place. With hats, furniture, clothes, and houses all the same, we could count the increased production we would gain as dearly paid for. Standardization and simplification do not necessarily mean this, however. Standardization means simply the determination and enforcement of standards that will enable the consumer to judge more intelligently and to fit the things offered in the market more easily and exactly to his needs; simplification means merely a reduction in the number of needless varieties and sizes in order that production and marketing efficiency may be attained. There is need for an organization or government department that will seriously devote itself to this task. Standards should be worked out following research on consumer requirements rather than on the convenience of productive methods. Specific goods should be tested against these standards and the findings published. Manufacturers and sellers should be required to label their goods conspicuously in terms of these standards.

Some idea of the savings that might accrue to the consumer following such a program may be grasped from the savings attributed to the work of the U.S. Department of Commerce Bureau of Standards, which performs tests on industrial commodities and articles purchased by the Federal government. In one year its staff of 800 scientists and technicians performed 180,000 tests, covering, among other things, electric batteries, lamps, clocks, watches, insulating materials, fuels, lubricants, optical instruments, paper, leather, rubber, textiles, brick, cement, sugar, and gasoline pumps. The bureau is estimated to have saved the government $100,000,000 in a period of a year on the purchase of supplies and equipment for various governmental agencies and to have saved particular industries large amounts through its work in simplification and standardization.[1] It is estimated, for example, that its work on builders' hardware, which resulted in the reduction of 100 nonstandard finishes to 25 standard finishes, has saved the industry around $10,000,000 a year. All this, of course, benefits the consumer indirectly; but there is, in addition, need for an organization that will approach the problem from his viewpoint and place the results before him in such a way that he can use them.

8. Final Criticism of Consumer Protection. Unbridled competition is not completely dependable in protecting the consumer against

[1] For an account of the methods and procedures utilized in government purchasing see TNEC Monograph No. 24, Chap. V.

high-priced and poor-quality goods and services. The reason for this is that the consumer because of his specialization has not the time to learn about the thousands of items which he requires in his daily living. Vendors, therefore, can in many instances make claims about goods wholly unsupported by fact. Moreover, even granting a nation of discriminating purchasers, the "guinea-pig" method of testing products leaves in its path the unfortunate victims of experimentation. Even though the company dispensing a deleterious nostrum is forced out of competition as a result of lack of custom in time, the harm already has been done. Hence, consumer-protective laws are required.

The old cry of some of the critics of our system, "There ought to be a law," is utterly ridiculous. There is a law. Indeed, there are hundreds of laws whose primary or secondary purpose is that of protecting the consumer. Many of these are quite adequate. Some, however, require amendment. Some, undoubtedly, require better enforcement procedure. In a few instances, perhaps, entirely new legislation is required.

Undoubtedly many of the legislative gaps existing in the past have now been plugged up.[1] Presumably, many of the states will follow

[1] As an example of the loopholes that existed previously, the following (from Ruth de Forest Lamb's excellent "American Chamber of Horrors," pp. 5–9) is presented:

"Widely advertised for years as an obesity cure, *Marmola* is composed essentially of thyroid extract and bladderwrack, a seaweed rich in iodine. Unquestionably, *Marmola* does reduce weight, but not without serious prejudice to health. By supplementing the natural thyroid secretion and stimulating the gland itself to greater activity, it causes the body tissues, including the fat, to be burned up at an abnormally rapid rate. Naturally, the weight goes down. But that is not all that happens! With a person whose thyroid gland is normal, the use of *Marmola* constitutes overdosage of two dangerous drugs. With one whose thyroid is already overactive, its use may bring about nervous and digestive disturbances, heart symptoms, headache, delirium, fever, and even collapse, coma and death. Obviously, it is not a product to be taken indiscriminately and without the advice of a competent physician.

"The nostrum is exploited by Edward D. Hayes, whose earliest ventures were with 'lost-manhood' cures when he was operating as the Dr. Knapp Medical Company and the Dr. Raynor Medical Company. . . . Hayes' case history serves admirably to show under what circumstances the Post Office can exercise control. For in 1904, when Hayes was using the mails to operate 'a scheme or device for obtaining money or other property by means of false or fraudulent pretenses, representations or promises,' the Post Office was able to interrupt his activities—for a time. This was accomplished by issuing a fraud order against his companies. . . . The fraud order, however, did not bother him much. He simply changed the name of his firm and went on as before until the Post Office caught up with him again. By one technicality or another, he seems to have

the lead of the Federal government and modernize their intrastate regulations also. Moreover, if the various Federal agencies develop cooperation techniques in handling cases arising in their various jurisdictions, even more can be expected.

Unquestionably we have made progress in nonlegislative consumer protection also. Partly because of governmental activity, partly because of an awakened social consciousness, and partly because people in the trades have discovered it to be good business, many business groups have taken definite steps away from the philosophy *caveat emptor*. This, too, is extremely encouraging.

It should be borne in mind, however, that the consumer cannot be protected fully in anything short of a completely regimented society. The reason for this is simply that the consumer cannot be protected

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kept a jump or two ahead of his pursuers until 1914. Then, the Post Office cracked down on his Interstate Remedy Company with a criminal prosecution. This time, he pleaded guilty and was fined $5,000. Worse still, from his point of view anyway, his precious sucker list numbering half a million names was ordered destroyed. . . .

"The Federal Trade Commission came into the picture in 1918 when it issued a complaint against the Raladam Company, as Hayes now called himself. In consequence, the company was ordered to stop advertising *Marmola* as 'safe, effective and dependable in use, when the present knowledge of thyroid as a remedial agent does not justify such representations.' Hayes promptly appealed —continuing, meanwhile, to rake in his profits. (He was doing a business of $600,000 a year.) Luckily for him, the appellate court decided that there was no basis in law for the action of the Commission, and vacated the order. While it would be to the interest of the public for *Marmola* to be put out of business, so the court reasoned, the Federal Trade Commission, under the powers given it by Congress, was not the agency to do it. This time, the Commission appealed. In a decision hailed with glee by the patent-medicine men and their trade papers, the Supreme Court decreed that the business of the Federal Trade Commission is to protect competition—though not necessarily that between knaves! Since it had failed to show any competition, the Commission had no power to act.*

"The Federal Trade Commission can do nothing about *Marmola*, the Post Office can not touch it—how about the Food and Drug Administration? It has no jurisdiction, either. Incredible as it may seem *Marmola* is not a 'drug' within the meaning of the Food and Drugs Act. The condition it is 'intended to cure, mitigate or prevent'—that is, obesity—is not one generally recognized as disease; its labeling (which means not only the label itself, but the printing on the carton and any folder inside) bears no other curative claims; nor does the stuff purport to be a food and therefore subject to the food provisions."

* Though this was not the end of governmental action in this case. "In May, 1935, the Federal Trade Commission issued a new complaint against the Raladam Company." The FTC finally won its case. See *F.T.C. v. Raladam*, 316 U.S. 149 (1942).

against his own poor judgment. He insists on buying large new cars when he should be purchasing better food for his family. He buys goods in the lowest priced lines, when the quality of goods must of necessity be low. Consumer education in purchasing is needed. The consumer must actually be taught to pay higher prices for goods in some instances.

Poor judgment is manifest at every turn. We criticize the old-time advertiser who mulcted the public of its dimes by offering a complete sewing machine for 10 cents and who upon receipt of the money delivered a needle. Should we not condemn the consumer who used such poor judgment in responding to such an obviously impossible offer?

It is the opinion of the authors that definitely harmful products are much less common now than they were a quarter of a century ago and that so-called *cures*, particularly for malignant diseases, are offered much less frequently than heretofore. The great bulk of consumer deception at present is in the relatively less serious area of overenthusiastic brand promotion and its common attendant, inflated price. As a corollary, there undoubtedly is a certain amount of short-weighting in retail transactions. Some of this is due to laxity in governmental departments charged with the responsibility of controlling dishonest practices. Some, however, results from the consumer's carelessness or ignorance. In a society such as ours, consumer education is probably just as essential as protective legislation. That is to say, training in an intelligent approach to marketing problems is necessary if consumer protection is to be completely effected.

Questions

1. To what extent is the consumer adequately protected in his purchasing activities in the United States at the present time by business competition?
2. Offhand, what areas does protection seem to be most inadequate—dangerous products, poor-quality commodities, excessively priced items? Give the reasons for your answer.
3. Is complete standardization of consumer goods practicable? Would the consumer position be improved greatly if such a program were carried through?
4. "With only its existing authority the postal inspection unit of the Post Office Department could, if given adequate man power, protect the consumer completely." Do you agree? Why or why not?
5. On a sampling basis of a number of magazines, including "slick" and "pulp" periodicals, classify the advertisements found therein as (*a*) evidently untruthful, (*b*) doubtful, (*c*) exaggerations, and (*d*) truthful. How do you explain the presence of advertisements in class "*a*," considering the legislation discussed in Chaps. VII and VIII?

6. Visit or write to the nearest Better Business Bureau and prepare a critical report on the accomplishments and limitations of such an organization.

7. On a basis of the most important types of commodities and services purchased by an average family, present a multiple cross-classification table rating our consumer protective legislation discussed in Chaps. VII and VIII (good, only fair, inadequate, or doesn't apply), with respect to their effectiveness in furnishing safeguards against (*a*) products which are dangerous to health, (*b*) products or services which actually are worthless, (*c*) products or services which are poor in quality, (*d*) products and services which, though of satisfactory quality, are excessively priced, (*e*) exaggerated claims of product or service quality or performance, and (*f*) the use of deceptive tactics in packaging or labeling. Complete the following form by adding lines and supply the information required in the spaces provided: Write a report on a basis of the table, indicating the areas where consumer protective safeguards are adequately provided, and areas, if any, where further consumer protective legislation is needed.

Specimen table:

Type of commodities or services	Consumer protective legislation		
	Federal Trade Commission	Pure Food and Drug Administration	Etc.
Food	(*a*) (*b*) (*c*) (*d*) (*e*) (*f*)	(*a*) Good* (*b*) Doesn't apply (*c*) Etc., etc. (*d*) (*e*) (*f*)	
Drugs	(*a*) (*b*) (*c*) (*d*) (*e*) (*f*)	(*a*) (*b*) (*c*) (*d*) (*e*) (*f*)	
Etc.			

* Applies to goods entering interstate commerce only.

CHAPTER IX

THE CHOICE OF GOODS

We know relatively little of the causes leading to the choice of goods. It is quite generally accepted that we start life with a certain inheritance of primitive fundamentals that are called *instincts.* There is no general agreement as to precisely what constitutes these instincts. Every book on psychology contains a list of them, and most of the lists differ; though instincts generally appear to comprise hunger, fear, rage, sex, gregariousness, etc. From these basic drives more complex reactions are built up from the experience of our environment. The learning process begins so early that it has been nearly impossible to differentiate between the part of our reaction that has been inherited and the part that is environmental. These instincts are, without doubt, of considerable importance in influencing certain broad lines of our expenditure, but they have little to do with our selection of specific commodities. The latter is primarily the result of our environment and seems to be made principally because of habit, impulse, or imitation, and only slightly upon the basis of any rational calculation.

1. Preferences of Consumers. The scale of commodities that a person consumes is built up in a more or less haphazard manner. Some of the commodities are acquired by a trial-and-error method. The consumer comes to expect a certain amount of satisfaction from a commodity from his previous experience with it. As has been suggested, certain commodities are included because other people are observed to be consuming them, and we think we shall derive something of the enjoyment that others seem to derive from their consumption; certain things widely consumed, whose omission in our consumption we believe would make us conspicuous, are also included. These are often consumed with but little feeling of satisfaction in the goods themselves. For example, many of the items of our apparel are uncomfortable, and if left to ourselves we would not choose to wear them; but in order not to appear conspicuous we comply with the whims of society.

There is no common quality of goods that makes them desirable. Desirability is solely in the reaction of the individual to the good and depends upon the individual and his environment rather than upon the good itself. For example, certain people like olives and others do not. The difference is in the individuals and not in the olives. The power that certain goods have to satisfy a want is called *utility* by the economist. Since this utility is purely psychic, we have no direct measure of it. We can only observe the effects as they are observed in price, and, from these, draw certain inferences. Thus, if we observe that a man is in doubt as to which of two things to spend a dollar on, we may infer, without great error, that they have about equal utility to him, or if he buys one in preference to the other, that the purchased goods possess the greater utility to him.

It is quite probable that each person derives a quite different satisfaction from the consumption of a particular kind of goods. This precludes any comparison of the satisfactions derived from the consumption of goods or a group of goods among different persons, or of any total or social summation of satisfaction. Moreover, since environment is constantly changing the individual, a person's desires at any one time may be quite different from those he has at some other time. There is not even any satisfactory unit of measurement by which an individual can compute the absolute amount of satisfaction that he derives from certain goods. This means that we cannot even sum up or total the satisfactions that a person derives from his income. A person calculates this satisfaction in terms of other goods. Thus it is impossible for one to tell another the satisfaction he derives from the consumption of a piece of candy or even to calculate it himself except in terms of other goods. One may, however, prefer the candy to a package of cigarettes or three packages of gum.

Many psychologists and economists object vigorously to the notion that individuals are at all rational in their attitudes toward goods—that they make conscious choices among goods on the basis of the utility which they have for them.[1] Men's motives, they say, are little understood, are very complex, and cannot be accounted for in hedonistic terms. Human behavior, according to these men, is not rational but is determined largely by the environment or circumstances

[1] See J. B. Watson, "Psychology from the Standpoint of a Behaviorist"; F. H. Allport, "Social Psychology"; T. Veblen, "The Limitations of Marginal Utility," *J. Pol. Econ.*, vol. 17, pp. 620–636; J. M. Clark, Economics and Modern Psychology, *J. Pol. Econ.*, vol. 26, pp. 1–30, 136–166; W. C. Mitchell, Human Behavior and Economics, *Quart. J. Econ.*, vol. 29, pp. 1–47.

in which man happens to be placed. It is a product of an unstable, irrational complex of reflex actions, impulses, instincts, habits, customs, climate, and fashions. People do not, in other words, make fine and precise calculations respecting the probable satisfactions to be obtained from the purchase of various goods. They are influenced rather by suggestion, advertising, accident, and many other factors. Their choices and price offers are determined more by custom than the relative utility of goods.

The truth of these statements cannot be denied. They hold true within considerable ranges of our expenditures, and in consequence the notion of the comparison of utilities cannot be pushed very far. But, at the same time, men are not completely irrational in the sense in which the man in the street uses the term. He does learn and build up a system of expenditures. He does select certain goods and thus choose in the ordinary sense of the word. Although these are serious limitations to the development of a satisfactory theory of consumption, they do not completely destroy the usefulness of the concept of utility. There still remain certain relations that may quite safely be stated and that lead us to concrete and useful conclusions.

The problems of choice with which the economists are primarily concerned are conveniently illustrated through the device of indifference curves. The basic assumption is that in most cases the consumer may substitute one commodity for another—*e.g.*, apples for oranges, Chevrolets for Fords, automobile for rail transportation, and so on. There is one group of exceptions to this general proposition where commodities are complementary. In such cases the consumer in using more of one good also uses more of the other. Examples are gasoline and tires, cups and saucers, and tables and chairs. For most commodities the consumer may use more of one and less of another as he wishes.

If the consumer can substitute one commodity for another, then he can find several combinations of the two commodities, say A and B, which are equivalent. For example, 10 units of A and 8 of B might be equivalent, as far as the consumer is concerned, to a combination of 9 units of A and 9 units of B. In such a case we say that the consumer is indifferent as between them. Such a situation extended to include a number of combinations of these two goods is shown in Fig. 5 by the line labeled I_0.

If to a given quantity of A—say 10 units—a larger quantity of B—say 10 units—is associated in combination, then this combination would be more desirable than the one which involved 10 units of A

and 9 of B. The new combination would no longer be represented by any point on the curve I_0. By extension of our previous argument, it would be possible to find other combinations of A and B which were equivalent to 10 of A and 10 of B, and a new indifference curve I_1, as shown in the figure, may be drawn. Points on the curve I_1 are all preferred by the consumer to those on the curve I_0. Following this procedure it is possible to think of an *indifference map* consisting of the whole set of indifference curves for an individual which serves to describe completely his scale of preferences for the two goods. To compare any two purchases as regards preference, we need only determine whether the corresponding points lie on "higher," "lower," or the same indifference curves.

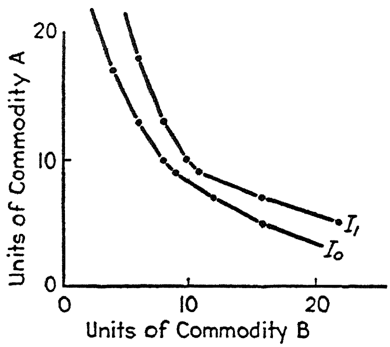

FIG. 5. Indifference curves of an individual.

Our basic assumption tells us only that some indifference map can be assumed. The assumption of continuity is now added for convenience. This assumption is that the individual can vary his purchases of each good continuously and that the variation from one set of purchases to indifferent purchases is continuous. We may then draw our map as a series of curves.

It is obvious that each individual will have a different indifference map. We may, however, specify certain characteristics of these maps which are believed to represent the "normal" case of consumer's choice. The first is the very reasonable assumption that no indifference curve intersects itself or another indifference curve. This means that there is only one direction of variation from a given set of purchases which leaves the consumer indifferent and that no set of purchases can be at two levels of indifference. The second assumption is that the level of preference increases as we move toward the upper-right-hand corner of our map. This fixes the order of ascending preference and the consumer is at a higher level of preference as he increases his purchases of both goods. From this reasonable assumption it follows that the level of preference can remain unchanged only if an increase in the purchase of one good is offset by the decrease in the purchase of the other. The indifference curves are thus downward sloping. The third assumption is that the more of A and less of

B a consumer has, the less attractive an additional unit of A will appear, relative to the loss of a unit of B. This means that the indifference curve is convex to each axis of reference.

We have expressed indifference in terms of two commodities, A and B, but we may equally well represent all commodities other than B along the A axis, treating them as a composite. This is a more realistic approach to the individual's problem with respect to a single good, although for clarity of explanation the use of two commodities is better.

2. The Effect of Price on Choice. Nearly all goods used by the consumer are purchased in the market, and since the consumer has a limited income, he must choose among these goods and apportion his expenditure among the various lines. He cannot consume all. In consequence, he buys some goods at the ruling prices and eliminates other goods at the ruling prices. It is quite evident that the consumer is influenced in his purchase by the price of these particular goods. We observe that if the price of a certain good drops, more is likely to be sold, and if it rises, less. These reactions may not be immediate, but for the market as a whole are certain.

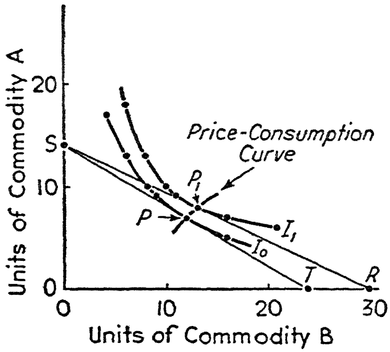

FIG. 6. The price-consumption curve of an individual.

The effect of changes in prices upon the takings of individuals may be illustrated by the use of our indifference curves. We mark off a point A on the vertical scale representing the number of units of A which could be purchased if all the income (S) point were spent on A, and a similar point for B (point T). A straight line connecting S and T will represent all the combinations of A and B which may be purchased at the prevailing prices with our given income. Among these possible combinations we will select the one which lies on the highest indifferent curve touched by the line ST. In our illustration this is P on the curve I_0. If now the price of B is lowered, we could buy some larger quantity, say OR, if all our income were spent on it. The line SR would now represent all the possible combinations of A and B which we could purchase with our income. Among these we would select the combination which lies on the highest indifference curve touching the line SR, in this case the point P_1 on I_1. The line

PP_1 representing the various quantities of B purchased as the price of B changes may be termed the *price-consumption* curve.

In our particular illustration note that not only more units of B are purchased at the lower price, but also more units of A, despite the fact that A's price has remained unchanged. If the indifference curves had been somewhat different from those in our diagram, the quantity of A might have remained unchanged or have actually decreased following the change in the price of B. A change in the price of B may thus change the quantity of A purchased by consumers as well as the quantity of B, and is in fact likely to do so.[1]

The reaction of consumers to price is not, however, as immediate and precise as this analysis would indicate. Within a considerable range of price and period of time, and depending upon the particular good, individual consumers do not pay as much attention to changes of price as is often thought. They find from experience about what a certain range may be expected to be, and it is only when prices lie outside this range that any considerable thought is given to the matter. For example, a man may have come to consider from $8 to $10 as his range for shoes in the market. He may give no thought to paying either $8 or $10 for a pair. He has come to expect to buy shoes for approximately that price. If he should find shoes selling for $15, however, he will consider other courses of action. He may decide to make the old shoes last a little longer, buy the new shoes with the expectation of using them more carefully than the old ones, or buy shoes of lower quality.

As has been suggested, the consumer is interested in deriving the largest possible satisfaction from the expenditure of his income. If he spends an excessive amount on one thing, he derives less satisfaction than if he had spent a portion of it for other things; for, as he expands his consumption of this particular thing, its relative significance per unit decreases and his dollars, in consequence, buy less satisfaction. He discovers that if he spends too much on this one particular line, he will not have enough to spend on other lines and he will feel quite definitely the lack of these goods. He learns with some definiteness the approximate amounts that can be spent on each thing. If a person has a fairly regular income, he is taught by this experience the

[1] A decrease in the price of B leads nearly always to an expansion in its consumption. There are, however, exceptions. On very low incomes an increase in the price of bread might be so important as to lead to a drastic reduction in other commodities and bread might remain the cheapest source of food and purchases increase. Such cases are extremely rare.

possibility of buying a certain amount of satisfaction in the market from each dollar that he spends. This provides him with a crude measure for judging the desirability of purchasing goods.

Returning to our indifference curves for the individual, we note that they indicate for successive points on the curve the amounts of one commodity which the consumer is willing to forego in order to have an increase of a certain amount in the compared commodity. The ratio of the quantity of B required to compensate for a unit of A is called the marginal rate of substitution of the two commodities. A little reflection will show that in order for the consumer to have correctly expended his income the marginal rates of substitution for all goods must be identical with their price ratios in the consumers' market.

3. The Effect of Income on Choice. The effects of changes in income may also be analyzed through the use of indifference curves. In Fig. 7 the dotted lines ST, $S'T'$, $S''T''$ represent the possible combinations of A and B that can be purchased at different levels of income with prices remaining unchanged. The line passing through Q Q' Q'' traces the changes in consumption at successive levels of income and may be called the *income-consumption* curve.

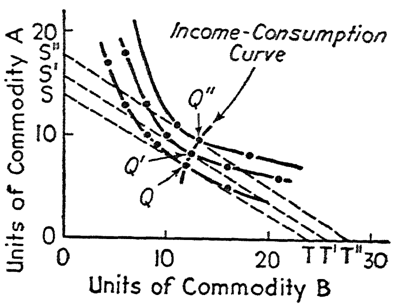

FIG. 7. The increase-consumption curve of an individual.

Usually an increase in income will lead to an expansion in the amount of commodities which the consumer is purchasing. These rates will vary among commodities and some study of them will be made in a later chapter. There are cases, however, where a smaller quantity of a commodity is purchased as the income is larger. Such commodities are known as "inferior" goods. They are largely consumed at low levels of income but replaced or partially replaced by goods of higher quality as income rises. Margarine is an example, and there are a number of others. In the majority of cases, however, consumption expands with a rise in income.

Changes in consumption usually require some time. A very large part of most people's current income is spent without the possibility of a great deal of shift in those expenditures. Past commitments of various kinds project legal or moral obligations into the future. People become involved in such things as rental contracts on leased

houses, purchase payments on homes, and debt payments that must be met if the family is to remain solvent. Other payments such as board and room, insurance payments, children's education, and so on create moral if not legal obligations. Such expenditures in the short run are largely automatic. As a person grows older a larger portion of the income generally comes to be obligated in such a fashion. One is likely to acquire family responsibilities and become increasingly aware of the necessity for provision for old age, as well as becoming more settled in habits. The younger age groups are certainly more susceptible to style and change in their pattern of expenditures than the older groups.

The typical individual receives his income in installments at particular periods of time. The earlier parts of the income period find him more receptive to buying appeals than later. Stores are well aware of this and direct their advertising more heavily at buyers on and near payday.

Each individual has a margin below which he does not consider it worth while to weigh expenditures. This margin will tend to be higher for those with large than for those with small incomes. The 25-cent tip, purchase of newspapers or magazines, or attendance at movies may fall below this level. The level will also change with the stage of the income period. Shortly after payday no thought may be given to the purchase of a $5 bottle of perfume, while later a 15-cent sundae may give pause. But even here there will be periodical check-ups and firm resolutions by the individual or family not to dribble money away with "nothing" to show for it. Over a period of time thought thus comes to be devoted to expenditures, and the situation approximates that indicated by our indifference curves.

The importance of a dollar to an individual depends not only upon the nature of the person, but a great deal upon the number of dollars which he possesses.[1] The loss of a few dollars from the income of a poor family may cause intense suffering, whereas the same loss would be scarcely felt in the income of a rich man. We say, in consequence, although always recognizing that there are exceptions, that the dollar has much greater significance to the poor man than to the rich man. It is interesting to note that divisible articles, such as meats, are varied in smaller units in size and price in shops appealing to the low-income groups than in shops catering to those with higher incomes. The dollar itself may not be a sufficiently large unit to impress maladjustments in expenditure upon a person. This depends upon his income.

[1] See A. Marshall, "Principles of Economics," 8th ed., p. 95.

The larger his income, the larger must be the maladjustment before it attracts his attention. A student may weigh the possibility of consuming the price of a pastry at the noon meal as against a larger dinner in the evening, while a businessman may give no thought to paying either $75 or $100 for a coat.

4. Limitations to Consumption. It is said at times that wants are insatiable. This, however, is not true. "No sound need is insatiable. The quantity of goods required to satisfy it completely is even smaller than might be expected. Consider, for example, the desire for knowledge. The mental receptivity of the masses is ordinarily very limited. Only a small minority aspires to better things. The great intellects whose aspirations are unbounded are few indeed. Even a Faustian intellect is satisfied by the known truth and is insatiable only in the sense that it searches in ever new directions and kindles new needs.

"There are degenerate needs that demand new sensual pleasures and constant change of refinement. Such needs are creative in augmenting new methods of enjoyment. But wherever man is influenced only by his own being, human nature prescribes narrow limits which cannot permanently be exceeded. Desires are only inflated to immeasurable proportions when the social degenerations of variety and love of fame are brought to bear."[1] This concept becomes much more practicable when, assuming a certain structure of society, one looks for the specific factors limiting consumption. In addition to the limitations of income and of physical satiety, one discovers many factors which affect the wants of individuals.[2]

For example, time limits the amount that each consumes. There is in other words, a tremendous competition for the consumer's time in modern society. Goods are not usually acquired just to have them. They are most often purchased for the purposes of consumption. And it must be admitted, "You cannot eat ripe, red cherries and drink sweet milk at the same time. You cannot climb an Alp and go swimming at one and the same instant. You cannot watch a motion picture while you are sleeping, nor can you grow chrysanthemums while you are flying in an aeroplane."[3]

Time, of course, is not the only limiting factor. Intelligence and skill are probably just as important. An absence of intelligence often

[1] Friedrich von Wieser, "Social Economics," p. 25.

[2] For a stimulating discussion of the several factors mentioned in the text see Walter B. Pitkin, "The Consumer—His Nature and His Changing Habits," pp. 85–244.

[3] *Ibid.*, p. 91.

affects income, for one thing, and also directly affects requirements. The unintelligent, often, do not experience wants of a higher order. Certain types of goods—books, for example—are not required by such individuals at all. Lack of requisite skill is a corollary. One need not ponder long the popularity of the radio. By the same token, one wonders whether there will be any considerable demand for pianos 50 years from now.

Moreover, energy and health must be considered as conditioning the capacity to consume. "The energy required to manufacture one unit of a commodity shrinks daily; but the amount needed to use up the commodity remains constant. Dancing, automobiling, touring, attending the opera, driving motorcycles, aeroplanes, racehorses, or steam yachts, and many other pleasures are exceedingly strenuous."[1] Much the same may be said of other types of consumption. Obviously health also affects consumption. For most things—foods, even—the point of satiety is reached much sooner if one's health is adversely affected. For other things—drugs, say—the rule works the other way. The individual who is mentally and physically well has no need for drugs at all.

Then there are constitutional preferences and habits. There is no gainsaying the preference of Americans for wheat rather than corn. There are other preferences just as strong which limit the consumption of certain types of commodities. Habits are closely allied phenomena. Individuals who habitually consume particular commodities can be induced to change only with difficulty, even though the new commodity serves the same purpose. Considering the fact that absolute limits exist in the total consumption of food by individuals, preferences and habits positively affect the amounts of particular foods required.

Age, finally, limits consumption. One has only to consider the physical limitations of the old to grant the truth of this assertion. That is to say, old people are usually inactive and, therefore, cannot consume certain types of goods. Indeed, even the consumption of food is often circumscribed, and one needs only few powers of perception to recognize the consumption limitations of children.

There are, then, many specific factors that tend to limit the wants of individuals. The law of satiety is of great importance in this connection. But so also are the limitations of time, energy, habit, and age. Perhaps the most important simple influence, however, is that of a limitation of income. Despite other limitations, people could

[1] *Ibid.*, p. 96.

usually consume much more than they do if only they possessed purchasing power.

5. Some Special Problems. Articles that last for a considerable period of time and cost large amounts may cause great inconvenience in purchase. If the payment must be made in a lump sum, it may, for example, demand more than the current income of the family. The shorter the period in which the payments are concentrated, or the larger the payments relative to income, the more burdensome they are likely to be. For example, the sacrifice involved in the purchase of a pair of shoes by a really poor family is more than is readily realized by those better situated. If the price must be taken from the sum allowed for food for a single week, the sacrifice will be more than it would if spread over several weeks. It follows from the principle of declining marginal rate of substitution among goods that the sacrifice necessary for the purchase of a commodity costing a considerable sum is much less if the amount is taken in small sums over a period of time rather than in one lump sum. The system of installment buying is in accord with this principle. Although we generally spend more in total in installment payments, the inconvenience which we suffer may be less through the spreading of our payments over a considerable period of time. It is not true that installment purchases are always desirable. As has been suggested in another connection, they open the possibilities of wise expenditure to the wise, but they also provide a dangerous means of foolish expenditure to the foolish.

The sacrifice of other goods that is involved in large purchases often prevents the purchase of an article in the form of a large unit even though single smaller purchases of the article or its services may have to be made subsequently. Thus a poor family might, with laudable economy, purchase coal by the ton at the beginning of a period, if it had the money that it will subsequently spend on coal. Since it does not have this money at the beginning of the period, it must adopt the more expensive method of purchasing coal in smaller lots or, perhaps, on credit. It has often been said, and with some degree of truth, that economy is a luxury of the rich.

Closely allied to the foregoing is the pressure on consumers of low income who, if they are to satisfy a broad scale of desires, are forced to purchase merchandise of low quality. Considering the fact that incomes are limited, the consumer is faced with the problem of choice arising out of the alternative of acquiring a relatively few items of high quality or a larger number of items of lower quality. The course chosen by the individual depends to a great extent upon his own par-

ticular standard of living, this in turn depending upon a myriad of environment influences. A great deal of intelligence is required to maintain a rational attitude in this matter. Unquestionably, some consumers maximize their satisfactions in choosing a large number of mediocre goods. But often, despite a rational attitude, an individual is not strong enough to withstand the tremendous pressure exerted by vendors of various goods. Consequently he chooses irrationally and as a result receives much less than maximum satisfaction.

Another general phenomenon that appears in the choice of goods by the consumer is his preference for present goods over future goods of like kind and quality.[1] When the consumer is presented with the alternative of having certain goods now or waiting until a later period, and the latter situation is expected to be essentially the same as the present one, he almost invariably elects to have the goods now. Future events appear less important than present ones. The longer the period, the greater the sum of goods in the future necessary to balance in the consumer's mind a certain sum of goods now. These conditions are demonstrated by observation and operate in typical cases. They do not hold for every individual, or for the same individual in all cases, but in general they are true. The extent to which men undervalue the future with reference to the present is called their *time preference* by the economist. Those who prefer goods strongly now relative to the future are said to have a high rate of time preference. Those who would be almost as willing to accept goods in the future as now are said to have a low rate of time preference.

The practical effect of this inverse telescopic faculty of looking at things is that persons sacrifice large quantities of goods in the future for the sake of smaller quantities of goods now. This may reduce materially the quantity of goods that an individual is able to consume during his lifetime. The general social result is that the creation of new capital is checked and people are encouraged to use up existing capital to such an extent that great future advantages are sacrificed for smaller present ones.

It is evident that the factors underlying the pattern of consumer choices are variable and complex, as are likewise the effects of prices and income changes upon his purchases. The indifference analysis, however, tends to crystallize the typical situation and to provide a mechanism for emphasizing the features of the problem that are of importance for the purpose of economics. Thus we see how, with a given set of indifference relations among goods, the consumer is led to

[1] See A. C. Pigou, "Economics of Welfare," 1st ed., Part I, Ch. II.

vary his purchases as these goods change in price or his income rises or falls. The price-consumption relationship shows the quantities of a particular good that the consumer would buy at various prices and constitutes his individual *demand* curve for that commodity. The income-consumption curve shows the changes in purchases with his income. Both of these underlie the market or group reactions discussed in the following chapters.

Questions

1. How, if at all, would shorter working hours influence consumer preferences for goods?
2. Support or argue against the contention that wants are insatiable. If prices were low enough would unlimited quantities of goods be taken?
3. List the things you want and use during a day. Try to figure out the source of each want. Which of these wants are a result of your environment?
4. Does the indifference curve analysis mean that rich people are happier than poor people? Why, or why not?
5. Some have argued that wants are insatiable. This contention has been disputed by some students of consumption economics. What is your opinion? Explain.
6. Is there any difference in the type of factors underlying the consumer's choice of oatmeal for breakfast, as against the choice of a particular brand of breakfast food, *e.g.*, Quaker Oats? Explain.
7. The text points out the many limitations in the quantity of goods that can be consumed. Does this apply equally to the variety of things and number of units of each thing? Does it apply also to the *quality* of products?

CHAPTER X

THE ELASTICITY OF DEMAND FOR COMMODITIES

The amount of a commodity taken off the market by consumers at a particular time depends upon a large number of factors. A useful classification of these factors includes (1) the psychology of the consumers, (2) the number of consumers, (3) the price of the commodity in question, (4) the price of other commodities, and (5) the income of the consumers. These factors, except for the number of consumers, are the same as those which we have just seen were important in the case of the individual consumer. In the analysis of most problems in economics the influence of price upon the quantity taken is of special significance. This relationship, in consequence, calls for a special concept: the demand curve for the commodity. This is a statement of the various quantities of a commodity that would be taken from the market at a particular time under different prices, if all the other factors were unchanged. Thus, as long as incomes, tastes, and the prices of other commodities remain unchanged, we assume there is a relationship between the price and quantity of a particular commodity taken from a market, and that this is stable during the period in question.

In the last chapter we have seen how an individual with a given set of tastes or preferences and buying habits, and with a given income, changes his purchases of a commodity as its price changes. These changes are traced by the price-consumption curve for the individual. For this individual, the amount of the commodity that he will buy at a particular price is called his *demand* for the commodity at that price. The entire list of takings at the various different prices constitutes his *demand* schedule for the commodity. Demand in the sense in which the economist uses the term is thus to be differentiated from want or need, neither of which is *demand.* If the tastes of the individual, or his income, or the prices of other products change, there will be a new price-consumption curve for the commodity. In this case we say that his demand for the commodity has changed.

A market is composed of a number of individuals. These will differ in income, tastes, and buying habits. Many will have different price-consumption curves and consequently individual demands for the

commodity. At a specified price some may buy a considerable quantity of the commodity, others a small quantity, and some none at all. The sum of all the individual demands of persons in the market constitutes the market demand for the commodity at that price. If the demands at a series of prices are arranged in the form of a table we have the market *demand schedule* for the commodity. The demands may also be expressed graphically by means of a curve, and this is known as the demand curve for the commodity. Both of these propose to show the relation between the price of the commodity and the quantity taken off the market, with all other things—such as the income of consumers, their tastes and buying habits, and the prices of other goods—remaining unchanged. If any of these other things change, then there will be a new demand situation to be traced by a new curve or reported in a new schedule, and we say that the demand has changed.

The general relationship prevailing between the quantity of a commodity taken from the market and its price at a given time is that a larger quantity of the commodity can be disposed of only at a lower price. There are two reasons for this. The first is that the price-consumption relationship of those already consuming the commodity is such that lower prices lead to the expansion of the consumption of the commodity. The second is that entirely new consumers are induced to purchase the commodity. The high price may have prevented consumption of certain commodities by considerable groups, but these groups may be led to purchase the commodity as the price drops.

The quantities of goods taken off the market, accompanying a given change in price, vary with different commodities. Some commodities are so firmly embedded in the consumption pattern that their purchase continues with little change in quantity in the face of large price changes. For other commodities, especially for those for which there are numerous substitutes, a small change in price will cause a large change in consumption. The nature of this relationship is described as the elasticity of demand for the commodity. If there is a large change in quantity accompanying a small change in price, the demand is said to be *elastic*. If a small change in quantity accompanies a large change in price, the demand is said to be *inelastic*.

The factors that are ordinarily associated with elasticity of demand are three in number. (1) The number of uses of a commodity is of importance, since commodities with many uses will tend to have more elastic demands. (2) Much will depend upon the number of

substitutes, those commodities for which there are many substitutes generally having more elastic demands. Substitution is possible among a great many food products and a number of the fruits, vegetables, and meats have considerable elasticity to their demand. (3) The importance of the expenditure on the commodity relative to the consumer's income influences the elasticity; the greater the amount taken by the commodity, the greater its elasticity is likely to be. Habit and the feeling that a good is a necessity, of course, tend to produce an inelastic demand. Marshall has pointed out that demand is, generally speaking, very inelastic for absolute necessities and for some of the luxuries of the rich that do not absorb much of their income.[1]

The most probable assumption for a demand curve of an individual buyer for ordinary commodities would be that the curve is inelastic at low prices, with the elasticity greater at the higher prices. The individual consumer is likely to reach a saturation point at some point where the price becomes low relative to his income, and below these prices his demand curve is nearly vertical.[2] The demand curve for the whole market will depend a good deal upon the number of classes in the market and how high the price is relative to their income. If the market is composed of a number of classes differing greatly in income, so that a fall in price not only results in a larger purchase by present consumers but also induces new groups to purchase the commodity who formerly refrained from purchase because of the high price, then the demand will probably be elastic. The larger the new group relative to the old, the more elastic the demand curve will be. If, on the other hand, the market is composed of buyers all alike in income and taste, then the elasticity is likely to decline as price falls.

1. Differences in Elasticity and Their Importance. The elasticity of demand for a commodity is expressed numerically by the ratio of the rate of change in quantity to the rate of change in price.[3] Roughly,

[1] A. Marshall, "Principles of Economics, 8th ed., p. 109.

[2] *Ibid.*, p. 109: "The elasticity of demand is great for high prices, and great or at least considerable for medium prices; but it declines as the price falls, and gradually fades away if the fall goes so far that satiety is reached."

[3] The following equations may be taken as defining the elasticity of demand:

$$(1)\quad E = \frac{dq}{q} \div \frac{dp}{p} = \frac{dq}{dp} \times \frac{p}{q}$$

$$(2)\quad p^E q = C$$

where q = quantity
p = price
E = elasticity of demand
C = constant

if 1 per cent in price is accompanied by a 1 per cent change in the quantity taken off the market, the elasticity of demand is 1. If a 1 per cent change in price is accompanied by a ½ of 1 per cent change in the quantity taken off the market, the elasticity of demand is ½. If a 1 per cent change in price is accompanied by a 2 per cent change in the quantity taken off the market, the elasticity of demand is 2. The elasticity applies only to small changes in price. In precise

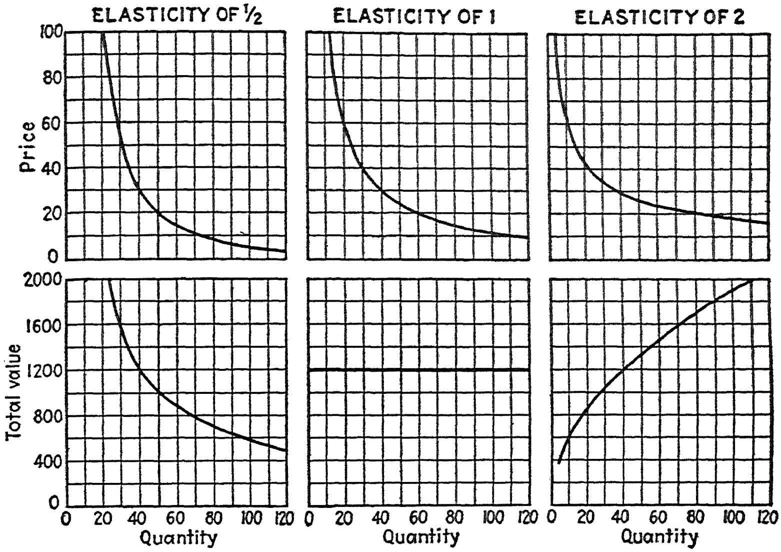

FIG. 8. Examples of demand curves of different elasticities.

terms, elasticity is a concept from differential calculus and refers only to a point on the demand curve. We have already pointed out that the number of consumers and their tastes and incomes vary in a market and in consequence elasticities of demand for a product may differ at various prices. Most demand curves have different elasticities in different portions of the curves.

The elasticity of demand of a commodity is of particular significance as an indication of changes in the total value of sales accompanying a change in price. When the demand curve has an elasticity of demand of 1, the total expenditures by consumers on the commodity will be the same regardless of the price of the commodity. When the elasticity of demand of a commodity is less than 1, the total expenditures of purchasers of that commodity will increase as the price rises. When the elasticity of the demand is greater than 1, the total expenditures of consumers for that commodity fall as the price

rises.[1] We may examine these circumstances for a particular commodity either in terms of the demand curve, the total value curve, or the changes in the total revenue, *i.e.*, the marginal or the additional revenue curve, selecting the particular expression that best serves our purpose in the analysis.[2]

Some of the consequences of the differing elasticities of demand may be illustrated with agricultural products for which supplies vary considerably from year to year. Potatoes are an example of a commodity with an inelastic demand. For such commodities a large quantity has a smaller total value than a small quantity. Large crops of potatoes, in consequence, bring farmers less in total dollars than small crops. Pork at retail, taking all cuts as a whole, has an elasticity approximating 1. An elasticity of 1 means that total sales remain unchanged regardless of quantity. Total expenditures on pork by consumers thus remain unchanged regardless of whether a large or small quantity is put upon the market. If we are able to guess what the expenditures on pork by consumers will be at a given time, we will thus be able to approximate the purchase price by consumers for a given output. Some of the fruits have elastic demands. In these cases consumers would spend more in buying a large than a small crop. There is one general law of demand, namely that if a larger quantity is to be disposed of in the market at a specified time, the price must be lowered. However, because the rate at which the price has to be lowered to dispose of the increase in quantity may differ, the total value of sales may either increase, remain the same, or decline. Which of these situations exists is indicated as soon as we know the elasticity of demand for the product.

[1] This may be readily shown as follows:

$$pq = V$$

where V = total sales, p = price, and q = quantity.

This identity may now be used to transform our earlier expression for a curve of constant elasticity $p^E q = c_1$ to the form $p^{E-1} V = c$. Examination of this equation shows that V must remain constant under all prices when E equals 1, decline in value as p increases when the elasticity is greater than 1, and increase in value as p increases when the elasticity is less than 1.

[2] The marginal receipts curve is the first derivative of the total revenue or total receipts curve. The principal relationships between the demand, or average receipts, curve and the marginal receipts curve may be summarized algebraically for curves of constant elasticity as follows: Demand or average receipts curve, $p = c^{1/E} q^{-1/E}$ multiplying p by q equals V or total receipts hence total receipts $V = q^{1-1/E} c^{1/E}$ and the marginal receipts curve is the first derivative of the above, or marginal receipts $M = (1 - 1/E)q^{-1/E} c^{1/E}$ or as frequently written $M = (1 - 1/E)p$.

2. Elasticity of Demand for the Industry and the Firm. There has been increasing recognition that the amounts of a commodity or product taken can be examined from several points of view. Thus, demand may be thought of as (1) a schedule of amounts taken at different prices by an individual buyer, (2) a schedule of amounts taken of a generic product by a group of buyers, or (3) a schedule of amounts taken of a particular brand of product by a group of buyers.

The first of these is not particularly useful in this connection except to emphasize the fact that the demand for any product is made up of the aggregate demands of many individuals; that is, schedules of amounts that would be taken at particular prices prevail for each of us, which in combination with those of others make up an aggregate demand situation. The last two are, however, very important both from a theoretical and from a practical point of view. What we are saying is that while the concept is important, one must proceed beyond a consideration of demand as the amounts taken of a general commodity (salt, say) if he is to obtain maximum value from a demand analysis. It is extremely useful to consider in addition the amounts taken of a particular seller's product ("Morton's Salt," for example), which might have entirely different characteristics.

The demand curve for the generic product is shaped as it is because (1) some consumers who will not buy at high prices *will* buy at low prices, and (2) some who will buy at high prices will buy *more* at low prices. Hence, under normal conditions a general price reduction in the industry would be expected to bring about *some* increase in sales.

The demand for a particular seller's product is a schedule of his share of total industry sales at various prices, given certain competitive price conditions; note that the individual seller's demand curve is conditioned by the existence of competitive offerings and the prices set thereon. Thus the response to one seller's price changes may be merely proportionate to the change for the industry or much more substantial, depending upon how competitors react.

This of course is a matter involving some rather subtle aspects of demand elasticity. The demand for the product of the industry might be quite inelastic providing there is intense need for the commodity and few substitutes are available, while the demand for the product of any one firm is highly elastic (assuming competitors do not meet the seller's price changes) because each seller's product is a perfect substitute for the others. Actually, under such conditions, sellers usually feel that they *must* meet rival prices.

Just one further point: under certain circumstances, at least, the demand curve of the individual seller is "kinked"[1] or "bent" because if the seller drops his price competitors are likely to meet it, since otherwise they run the risk of losing the large proportion of their volume; but if the individual seller raises his price, rivals may *not* meet it (because they need not) and if not, he must retreat or be faced with a loss of much if not all of his volume. Thus, under certain conditions, the individual seller's demand curve possesses the same degree of responsiveness to price change as that of the industry curve *below* the prevailing price and flattens out *above* that price.

3. Elasticity of Demand and Monopoly Action. Whenever control can be exercised over the quantity offered for sale in the market, the elasticity of demand evidently enters as a factor determining the most desirable quantity to be offered. As long as the elasticity of demand is less than 1, gross revenue will be increased by raising price and curtailing the quantity sold. If the elasticity of demand is 1, raising the price and curtailing the quantity sold will yield the same gross revenue as a larger quantity of sales at a lower price; whereas if the elasticity of demand is more than 1, raising the price or curtailing the quantity sold will decrease gross revenues.

The nature of the demand curve is unknown for a number of products and is the subject of speculation by businessmen. Some years ago, when the railroads were facing financial difficulties, a group of railroad presidents met to discuss policy with respect to rates. Some argued that rates should be increased and others that they should be lowered. The first group evidently thought that the demand for railroad services was inelastic, while the latter group thought it elastic. The American Telephone and Telegraph Company has found it good policy to lower evening long-distance rates while maintaining the old level of day rates. Evidently the demand for evening long-distance calls is elastic, while that for day calls is inelastic.

There is considerable evidence that businessmen are inclined to consider demand curves for their products more inelastic than they actually are and that vigorous action in drastically reducing prices well beyond previous levels uncovers a volume of purchases previously thought impossible. For example, "In November, 1938, as a promotion scheme, a New York newspaper offered classical albums to its readers at prices averaging about 49 cents per record. At a

[1] For a discussion of this, see R. L. Hall and C. J. Hitch, "Price Theory and Business Behavior," *Oxford Economic Papers*, No. 2, pp. 12–45, May, 1939.

time when the record companies considered that the average sales of a classical album should be about 6,000 sets, and a sales volume of 10,000 sets, even over a period of two years, was extremely unusual, the newspaper sold more than 50,000 sets of a single symphony in a few weeks. There was a belief that the people of the United States had come to appreciate music of all kinds more than previously because the radio had accustomed them to hearing music every day."[1]

Books offer another interesting case. "The ceiling for detective stories [at original prices, usually $2.00] is 20,000 copies (it was somewhat lower before the war). Any author who sells in the 15,000 to 20,000 bracket is tops. . . . In the reprint market [on the other hand] detectivation may sell prodigiously. . . ."[2] One comparative newcomer in this market, Craig Rice, has sold over 550,000 copies of one title, and even sales of a million Pocket Books at 25 cents is not unheard of.[3] Viewing the situation broadly, the demand turns out to be very elastic. When price is reduced to one-eighth of the original figure the number sold is fifty times that ordinarily expected at the original figure.[4]

The significance of these examples lies in the suggestion of the great consumer response that might result if prices of some other commodities could be greatly reduced relative to current levels. In such cases employment in the field would increase and consumers would gain. One close student of the operation of the economic system has maintained that continuation of our existing system depends in large part upon the vigorous development of low-price policies by our large-scale organizations.

The possible success of a production-restriction program such as that instituted under the AAA depends very much upon the elasticity of demand for the particular product. Under this program farmers

[1] McNair, Learned and Teele, "Problems in Merchandise Distribution," p. 479.

[2] *Time*, Jan. 28, 1946, p. 84.

[3] *Ibid.*, p. 86.

[4] It is interesting to note in this connection the following statement: "Before this year is out, the five companies that manufacture most of the 25-cent reprints [Pocket Books, Bantam, Penguin, Dell, Avon] will have produced about 110,000,000 copies of same. . . . Six million Pocket Books sold in the first full year; 9,000,000 in 1941, and so on . . . a total of 144,000,000 to date, or more than the combined total of all best sellers published in the United States since 1880, including major book club selections." John B. Hutchens, Publishing's Lively Child, the Twenty-five Cent Reprint, *New York Times Book Review*, May 5, 1946, p. 3.

were allotted certain quotas for production or marketing which in total were to be set at an amount which reduced market supplies. Where the commodities had elasticities of demand of less than 1, the smaller quantities marketed would result in larger total consumer expenditures and there was considerable probability that this would result in larger net returns to producers. If the restriction were of a commodity having an elastic demand, there would be much less probability of an increase in the net returns of producers, for total expenditures for the commodity by consumers would fall and total costs would have to fall even more rapidly in order to increase these net returns. In the case of commodities with elasticities of demand of 1, the gain would be such savings in costs as resulted from the production of a smaller volume.

Whenever a total market is divisible into sections or smaller separated markets with different elasticities of demand or of varying size, an arrangement of prices or quantities can usually be found that will produce a larger gross revenue from the sale of a given quantity of goods than when a uniform price prevails in all the markets. The principle to be followed in order to secure the greatest income for a given supply is to equalize the marginal net returns in each market. If goods sold in one market would produce larger net returns if sold in another market, there would obviously be gain by their diversion.

In some cases, the division may be secured through alternative uses for the product or raw material. An example may be taken from city milk markets. Bottled fluid milk is thought to have generally an inelastic demand, cream an elastic demand, and manufactured dairy products elasticities of demand close to 1. Let us assume a market in which milk may be used interchangeably in these various ways. In a competitive market, the amount of milk used for the various purposes would be adjusted so that the same price for milk would be secured in each of the uses. A single price for milk as a raw material would prevail. Otherwise, advantage would accrue from shifting milk in the class of relatively low return to the class or classes where it possessed a higher value. If a single distributor had a monopoly, however, he could increase his returns above the competitive level even though he disposed of the same total quantity of milk as before. This would be accomplished by raising the price of the bottled milk, curtailing the quantities sold, and thus increasing total consumer expenditures for fluid milk, while if the diverted milk were placed in a use having an elastic demand, total revenues from this source would also be increased.

Another important group of cases is where there is a protected or home market for the producer and a larger open or world market to which he can ship or dump such quantities as he desires without influencing the home market price. Even though the elasticities of demand are the same in both markets, because the domestic seller is only one of many suppliers on the larger market, the demand curve for his product will be more elastic than the total demand curve for the whole market. A doubling of the quantity of his sales may increase the supplies in the market as a whole by only a few per cent, with a consequent minor influence upon price. Wheat may be used as an example since it is a commodity that probably has an inelastic demand in the United States and in the world as a whole. An overhead marketing organization with control of all the wheat to be sold by producers in the United States could, disregarding antidumping laws and other retaliatory measures, under the protection of our tariff curtail wheat sales in this country, thus raising domestic prices, and dispose of the resulting surplus together with our usual exports on the foreign market, depressing the world price only a little. The result would be to increase the total sales value of a given crop of United States wheat.

The advantage of this sort of arrangement leads every businessman to endeavor to create a special or protected market for his product and to seek a larger market elsewhere in which he can dispose of his excess production. The various devices and procedures followed are described in other chapters.

4. Individual Product and Total Market Demands. The more readily one commodity may be substituted for another, the less it can rise in price without itself being replaced by the alternate commodity. There are many degrees of substitution—indeed, in a broad sense nearly every commodity is a substitute for another. There are, however, certain groups of commodities among which substitution is direct and quite rapid. The various brands of particular products tend to fall in this group. Thus evaporated milk is well standardized and one can is about the same as another except for the paper label on the outside. Insofar as consumers are aware of this, if one brand were lowered in price to 9 cents at retail while the others remained at 10 cents, they would shift to the consumption of the lower priced brand. We need, therefore, to distinguish between the total market demand for a product and the demand for the products of an individual firm in that market. This latter demand curve will tend to be highly elastic as long as other sellers in the market retain their prices

unchanged while the particular firm is changing the price on its product, as was mentioned earlier.

The greater elasticity of the individual seller's curve in these circumstances is a powerful force toward the lowering of prices. If other sellers will retain their previous prices, then the individual seller may gain considerable patronage by a lowering of price. If, however, other sellers retaliate by also lowering their price, then at the new market price the price-cutting seller will have no special advantage and his sales will probably approximate about the same proportion of the market total as before prices were lowered. If the market demand as a whole for the product is inelastic, the net result of the price-cutting episode by the individual seller will be a lowered market price with smaller total expenditures by consumers for a slightly increased volume of sales. The profits of all sellers, including those of the price cutter, will be lessened and losses for some sellers may result. Insofar as the particular seller is aware of the probability of these results he will be restrained from cutting the going market price. These circumstances are also in part responsible for the bitter feeling held by businessmen in many cases against the price cutter.

If the price-cutting seller is small or his brand unknown, it may cost less for the rest of the market to ignore him and allow him to make some inroads on the market, than to lower prices generally. Thus in many markets unadvertised brands sell for less than advertised brands, or small sellers undercut the prices of large sellers as a means of gaining trade. If this becomes extensive, however, there will be a readjustment in the market price. As has been noted earlier, certain firms in many cases come to be market leaders with respect to price, and changes in their prices are adopted generally by the market.

5. Determination of Elasticities for Particular Commodities. The nature of the demand curve as we have defined it and its elasticity are not known precisely for any commodity. This must necessarily be so since the demands in any situation do not remain the same, but in fact change. The only recorded fact that we are able to grasp as a statistical datum is that at a certain period a given quantity was disposed of in a market at a particular price. This sets one point upon a demand curve; the others are tentative or hypothetical—the quantities that would have been disposed of at other prices, which prices in fact did not occur. Nevertheless, because of the great usefulness of such estimates, attempts have been made to arrive at a notion of the

approximate character of the curves for the more important commodities.

The most usual method is by a statistical comparison of past production or sales and price. The method consists in the comparison of prices and quantities of goods for comparable past periods, months, years, or seasons. After proper statistical correction for changes between these periods, the data are presumably upon a basis that represents what the relationship between prices and quantities would have been in any one of them. Since because of unusual or unmeasurable factors the corrections are not complete, the particular observations do not lie on a perfect curve and it is necessary to draw or fit a curve to the observations. In the case of agricultural products, where there are often large variations among years in the quantities marketed, the method appears to give fairly satisfactory results. Figure 9 shows the relationship between the price and consumption of potatoes in the United States during the 1930's.[1]

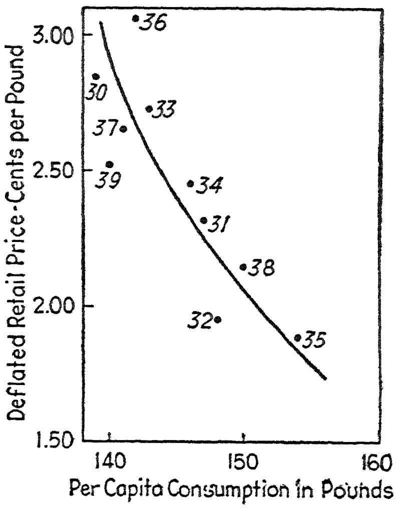

FIG. 9. Demand curve for potatoes in the United States in the period 1930 to 1939.

The curve that is derived by this method cannot exactly represent the demand curve of the economist for a particular period. The statistician's demand curve represents a series of equilibrium points between demand and supply, usually the relation between the particular annual quantities and the seasonal average prices, and this curve

[1] When it is desired to determine the elasticity of a demand curve which has been drawn on a graph, a convenient method is to select two points on the curve, P_0Q_0 and P_1Q_1, and compute the average elasticity between these points. The formula is

$$\frac{\dfrac{Q_0 - Q_1}{Q_0 + Q_1}}{\dfrac{P_0 - P_1}{P_0 + P_1}} = E$$

In this formula P_0 represents the price at the first selected point and Q_0 the corresponding quantity, while P_1 represents the price at the second selected point and Q_1 the corresponding quantity.

may be quite different from the actual demand curve at a particular period of time. The difference depends largely upon the variability of the demand and supply curves during the time under study. If the demand curve had remained constant throughout the period and supply alone had varied, a "true" curve would be given. But when

TABLE 18. ELASTICITIES OF DEMAND DERIVED IN CERTAIN STATISTICAL STUDIES IN THE UNITED STATES

Commodity	Market	Elasticity	Years
Milk	Boston, Class I	0.07	1922–1931[a]
Milk	Several markets, fluid	0.27	1934–1935[b]
Sugar		0.31	1915–1929[o]
Wheat	Chicago	0.36	1896–1913[c]
	Chicago	0.24	1921–1934[c]
Wheat	U.S. farm	0.21	1921–1934[o]
Lemons	California	0.33	1910–1937[d]
Potatoes	Minneapolis	0.46	1902–1924[e]
Potatoes	U.S. farm	0.30	1915–1929[o]
Corn	Chicago	0.59	1897–1929[f]
Corn	U.S. farm	0.49	1915–1929[o]
Rice	New Orleans	0.65	1914–1929[g]
Coffee	Import price	0.75	1881–1913[h]
Pork	U.S. retail	0.93	1922–1930[i]
Peaches	U.S. farm	1.20	1910–1915 and 1921–1925[j]
Apples	New York, wholesale	1.42	1898–1899 to 1914–1915[k, l]
Beef	U.S.	1.97	
Lamb	U.S.	1.58	1907–1926[m]
Bananas	New York, wholesale	2.56	1897–1914[n]
Barley	U.S. farm	0.53	1915–1929[o]
Oats	U.S. farm	0.60	1915–1929[o]

[a] JOHN CASSELS, Fluid Milk Programs of the AAA, *J. Pol. Econ.*, vol. 43, p. 416, 1935.
[b] E. W. GAUMNITZ and O. M. REED; Some Problems in Establishing Milk Prices, *USDA DM-2*, p. 44.
[c] H. WORKING, The Elasticities of Demand for Wheat, *Econometrica*, vol. 5, pp. 185–186, 1937.
[d] H. WELLMAN and E. BRAUN; Lemons, *Calif. Agr. Exp. Sta. Bull.* 460, p. 20.
[e] H. WORKING, Factors Affecting the Price of Minnesota Potatoes, *Minn. Agr. Exp. Sta. Tech. Bull.* 29, p. 13.
[f] R. W. COX, Factors Influencing the Price of Corn, *Minn. Agr. Exp. Sta. Tech. Bull.* 81, p. 23.
[g] E. J. WORKING, Changes in Demand, *J. Farm Econ.*, vol. 14, p. 244, April, 1932. Read from graph.
[h] E. W. GILBOY, The Leontieff and Schultz Methods, *Quart. J. Econ.*, vol. 44, p. 233, 1930.
[i] WORKING, *op. cit.*, p. 246.
[j] E. M. DAGGIT, "Yearbook of Agriculture," 1936, p. 566.
[k] G. F. WARREN and F. A. PEARSON, New York State College of Agriculture, *Farm Economics*, No. 48, p. 777.
[l] M. Ezekiel, reported by Warren and Pearson in Interrelationships of Demand and Supply, *Cornell Bull.* 466.
[m] M. EZEKIEL, Factors Relating to Lamb Prices, *J. Pol. Econ.*, vol. xxxv, p. 241, April, 1927.
[n] WARREN and PEARSON, *op. cit.* p. 778.
[o] HENRY SCHULTZ, "The Theory and Measurement of Demand."

the demand curve changes, or varies its position, then the curve yielded by the statistical method cannot be the actual curve at any one period. The degree to which the actual curve is approached by the statistical curve depends largely upon whether, during the periods from which the data are drawn, the uncorrected variation has been greater in the supply or in the demand curves. If the variation has been principally in the supply curves, the statistical curve will approach closely the curve existing at any one period.

At various times a number of commodities, chiefly agricultural products, have had their elasticities of demand computed by various investigators. The following table presents a summary of some of these results. The statistical results in all methods appear to be open to a wide margin of error and are in all cases to be interpreted with great caution. Fortunately, for many problems it is necessary to know only the elasticity within wide limits to indicate the nature of the solution, and for this the statistical results are generally of sufficient reliability.

6. Some Further Applications of Elasticity. The elasticity of demand is a factor of importance in a number of economic problems. We have already indicated its significance in the case of the action of the monopolist. The effect of a laborsaving device upon the laborers employed in the industry in which the device is introduced turns largely upon the elasticity of demand for the commodity they are producing. If the demand is inelastic, labor is certain to be forced out of this industry, while if the demand is elastic even more labor may be employed than when the device was introduced. Thus early introductions of machinery in the manufacture of cotton appear to have increased the amount of labor used in that industry. Prices of cotton at that time were relatively high and the demand was elastic. Later introductions of machinery after the price had become relatively low and the demand inelastic appear to have forced labor out of the industry.[1]

The elasticity of demand also has important bearing on the results of a tax. If the commodity has an elastic demand, then if there is an increased price for the commodity as a result of the tax, the quantity taken by consumers will decrease greatly and the tax base will shrink. If, however, the commodity has an inelastic demand, nearly the same amount of the commodity will be taken despite the higher price. As is pointed out later, the ease with which a tax may be passed on to the consumer in the form of a higher price depends on

[1] A. C. Pigou, "Economics of Welfare," 1st ed. p. 717.

the elasticity of demand for the article. If the demand is inelastic the consumer is likely to bear nearly the full burden of the tax in the form of a higher price, while if the demand is elastic a very large share of the burden will probably be borne by the producer of the commodity.

The Food Stamp Plan of the 1930's depended for its success in raising the income of farmers on the relative elasticities of demand

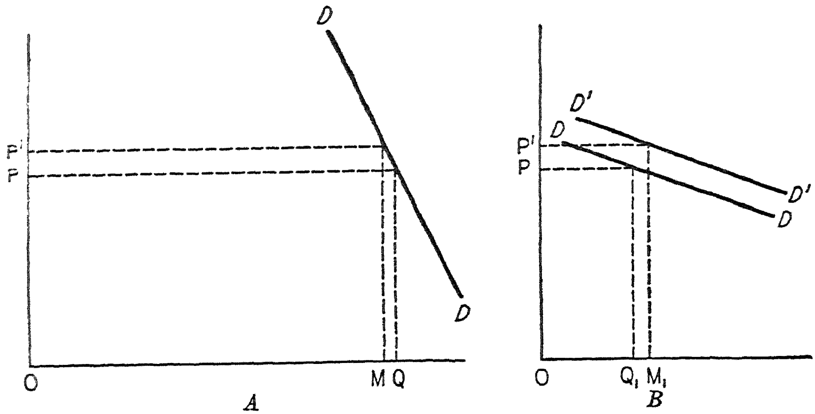

FIG. 10. Effects of a Food Stamp Plan.

for food by different groups in the United States. Under this plan, designated low-income groups who bought one dollar's worth of orange stamps per person per week received free 50 cents' worth of blue stamps. The orange stamps could be used for any food purchase, but the blue stamps were restricted to payment for foods designated as surplus foods. The effect of the plan upon the blue stamp commodities is illustrated in Fig. 10. The demand of those receiving stamps is the *B* part of the figure while the regular market is shown in *A*. *DD* represents the demand curves in these markets before the issuance of the stamps, OP the price in each market, and OQ and OQ_1 the quantities taken by the consumers. Issuance of the blue stamps gives the recipients larger purchasing power and their demand is increased and now represented by the curve *D'D'*. The quantity purchased by this group is now OM_1. Assuming the same total quantity available for sale in the market as formerly, OM is now available for purchase by consumers in the regular market and the price rises and becomes OP′ in each market. Total expenditures by consumers on the commodity are larger than formerly by PP′, the price rise times the total quantity sold. If the demand in the

regular market is inelastic, total consumer expenditures in that market will have increased. If the blue stamp expenditure in the *B* market is a net addition to the old expenditure, total consumer expenditures on the commodity will have increased by more than the amount of blue stamps used in purchasing the commodity.

The effect of the Food Stamp Plan on farm income evidently depends upon four things: (1) the amount of the blue-stamp subsidy; (2) the extent to which this subsidy represents a net addition to the preplan food expenditure of the participants; (3) the elasticity of demand of consumers who do not participate in the plan; and (4) changes in marketing charges. The more inelastic the demand in the *A* market, the greater will be the price increase, the increase in total consumer expenditures, and probable increase in farm income. If the demand in the *A* market is highly inelastic the price increase could be such that those in the *B* market could obtain only a little more food even with their blue-stamp subsidy. Actually any benefits of the plan are shared by both the farmers and the low-income participating consumers, but for any given subsidy, the greater the benefits to one group, the smaller the benefits to the other. The extent to which the consumers in the *A* market contribute to the plan depends upon their elasticity of demand for the product.

Another proposal to increase farm incomes has been that of a "two-price" plan for certain agricultural commodities. In this plan the high-income group would pay one price, while the low-income group would be aided in their consumption by a subsidized lower price. Since the plan has for its objective an increase in the income of agriculture and an enlarged consumption by the low-income groups, the successful operation of the scheme would necessitate an inelastic demand for the product by the high-income group and an elastic demand in the low-income group, in the relevant price ranges. Rearrangement of a given volume of the product in such a situation would permit prices resulting in a larger total consumer expenditure and expanded consumption by the low-income group. If the high-income group had an elastic demand and the low-income group an inelastic demand, the plan could not attain its objectives. These few examples will serve to suggest the importance of the knowledge of elasticity of demand in the solution of specific economic problems.

Questions

1. In a real sense standards of living act as a framework for consumer demand. What in your opinion does this statement mean?

2. One economist recently suggested the need for a reconstituted demand curve after the initial purchase is made. What would the effect of this be on the demand for rolled oats? Refrigerators?

3. What is the significance of the time element on demand elasticity?

4. Sears, Roebuck with its low price policy very likely gains more from the existence of an elastic demand for the product of the firm than from elasticity of demand for the product of industry. Explain.

5. If a commodity with an inelastic demand, say wheat, were heavily taxed and the price in consequence increased, how would you expect the demand for other commodities to be affected? Explain.

6. How would the elasticity of demand for various commodities be a factor in the setting of rates by a group having a monopoly of the transportation to an otherwise isolated community?

7. Warren and Pearson have said that large crops generally bring the producer less and cost the consumer more than small crops. What demand situation would make this possible?

8. Which would you expect to have the greater effect upon its price, a restriction in the supply of nails or a similar restriction in the supply of lumber?

9. Would a flat sales tax of, say, 2½ per cent affect all businesses similarly?

CHAPTER XI

DEMAND MANIPULATION AND THE CONSUMER

The irrationality of consumers and their susceptibility to suggestion in their consumption habits provide an opportunity for the individual businessman to attempt an increase in his sales through aggressive advertising and salesmanship. A large part of consumption is, in consequence, directed to a considerable degree by such sales-promotional efforts. One writer has estimated that consumers have conscious wants for about half the things they consume and that they depend upon suggestion and direction for the selection of the other half.[1] This direction of consumption by the businessman for his own profit is probably not entirely desirable since consumers may be made to want and consume goods that are not for the best interests of society. The seller of a particular product cares little whether the consumer might better expend his income along other lines if only an increase in the sales of his particular product can be obtained. The motives that are exploited for the purpose of selling goods are not always the characteristics most desirable to have exploited. The seller, through study and subsequent trial and error, selects those appeals that are likely to prove most effective in the sale of his product and is probably more apt to exploit human weakness than to develop desirable characteristics. A greater number of appeals, for example, are made on the basis of sex emotions than on the basis of intellectual or moral values.

It should be quite clearly understood at the outset, that in general, advertising and salesmanship have only one fundamental purpose—that of increasing the desire of the consumer for particular products. From a technical economic point of view the advertiser's aim is twofold. He attempts (1) to move his whole demand schedule to the right (create an actual increase in demand) and (2) to "perpendicularize" the demand schedule (create a more inelastic demand) for his product. Regardless of the techniques employed, these are the basic purposes of sales-promotional endeavor. Though originally the term *advertising* signified *communication,* it now connotes some

[1] See G. B. Dibblee, "The Law of Supply and Demand," Chap. XV.

sort of persuasion, and almost every known method of attack—deception, cajolery, vulgarity, and even truth—has been used in the persuasion process.[1]

1. Expenditures for Demand Manipulation. In the broad sense, demand manipulation includes *all* sales-promotional activities. That is to say, the cost of advertising is only one part of the total cost of selling. It is, however, impossible to isolate certain types of sales

TABLE 19. ADVERTISING AND SELLING EXPENSE PER DOLLAR OF NET SALES FOR SELECTED INDUSTRIES, 1940*

Industry	Number of corporations	Advertising	Selling and delivery	Total advertising, selling, and delivery
Cosmetics†	8	20.65	10.01	30.66
Drugs and medicines	20	13.94	13.41	27.35
Cereal preparation	14	13.08	5.77	18.85
Cigarettes	10	11.30	4.60	15.90
Soaps and cooking fats	20	10.94	8.89	19.83
Distilled liquors	14	9.79	10.52	20.31
Tobacco products	6	8.20	10.60	18.80
Cigars	12	5.40	7.40	12.80
Fruit and vegetable canning	49	4.49	6.87	11.36
Men's and boys' clothing sold through own stores	5	4.20	20.90	25.10
Men's and boys' clothing sold to trade	21	3.60	6.40	10.00
Flour milling	22	3.03	6.22	9.25
Bread and bakery products	82	2.63	24.24	26.87
Biscuits and crackers	7	2.60	23.23	25.83
Refrigerators and airconditioning equipment	21	2.02	8.45	10.47
Motor vehicles	23	1.94	3.29	5.23
Furniture	71	1.59	8.85	10.44
Hardware	35	1.06	8.38	9.44
Rayon and allied products	14	.87	2.07	2.94
Cotton textiles	56	.46	3.41	3.87
Cane sugar refining	17	.17	4.62	4.79

* SOURCE (except cosmetics): "Advertising as a Factor in Distribution," Report of the Federal Trade Commission on Distribution Methods and Costs, Part V, pp. 6, 7.

† As reported by DUDDY and REVZAN ("Marketing," p. 620) from FTC figures published in *Printers' Ink Monthly*, August, 1944.

[1] Although persuasion is generally utilized to increase sales, one of the by-products of the persuasive process no doubt is the increase in satisfaction of those who have already acquired the product. This, of course, is offset to some degree at least by the dissatisfaction created in those who purchased earlier models or styles.

cost. Thus the cost of personal selling (particularly the persuasive phase) is practically imponderable. Because of this, and since advertising is both insidious and ubiquitous,[1] attention in the following discussion will be directed toward the nonpersonal type of demand-manipulative activity. Many of the points, however, apply with equal force to personal demand-manipulative efforts.

TABLE 20. ESTIMATED ADVERTISING EXPENDITURES IN THE UNITED STATES, 1941 AND 1945*

	1941	1945
Newspapers	$610,000,000	$660,000,000
Direct mail	315,000,000	270,000,000
Radio	225,000,000	400,000,000
Magazines	180,000,000	330,000,000
Outdoor	65,000,000	90,000,000
Trade and business papers	55,000,000	107,000,000
Farm papers	16,000,000	29,000,000
Miscellaneous (including the administrative costs of advertising departments)	454,000,000	500,000,000
Grand total	$1,920,000,000	$2,386,000,000

* Estimates by L. D. H. WELD as published in *Printers' Ink*, Mar. 27, 1942, p. 19; and Mar. 15, 1946, p. 21.

Several points should be kept in mind in this connection, however. (1) If there is any waste in advertising, it should not be condoned on the ground that it is only a minor percentage of national income. (2) The social effect of advertising may be much greater than is indicated by the amount of the expenditure. (3) As is shown by the figures in Table 19, advertising expenditures in certain fields in terms of a percentage of the consumer's dollar are quite significant. (4) Advertising may permit higher prices to be charged for products by giving the seller a quasi-monopolistic position in the market. These costs to the consumer may be many times the advertising outlay.

The expenditure for advertising has increased tremendously over a period of years. Advertising expenditures in the United States in 1929 were more than eight times those of 1900 and were probably in excess of 1¾ billions. The figures in Table 20 are estimates indicating the dollar expenditures in each type of medium for 1941 and 1945.

[1] Advertising differs from most other types of demand-manipulative effort in that (1) it invades the home when one's defenses are down and (2) it is impossible to avoid because of its universality. One needs only to listen to a broadcast to appreciate the former contention; to pick up a magazine, turn on the radio, or go out riding (past thousands of billboards) to appreciate the latter.

2. Advertising—Beneficial or Harmful? Because of its nature—the fact that it is continually in the public eye—advertising is a subject of constant debate. Some argue that it is one of the greatest causes of waste in our economic system. Others contend that it is an extremely efficient economic tool; that, instead of being a wasteful device, it actually increases economic well-being. One reason for divergent views regarding advertising is that often each school of thought argues from particular cases, each arguing without benefit of a satisfactory theoretical analysis. Another reason, very closely allied to the first, is that each approaches the problem from an entirely different point of view. One is biased by *individual* considerations; the other looks only at *social* consequences. One sees a definite advantage accruing to the businessman, who, by means of advertising, sells a million boxes of "cold-prevention" tablets; the other recognizes the social loss resulting from the sale of such a worthless compound.

The Individual Point of View. There is little question that, for some types of commodities and under certain circumstances, advertising can be used effectively in the sale of goods of individual sellers. Advertising is being constantly and successfully utilized in the process of:

1. Increasing the number of users of products.
2. Increasing the number of uses to which products may be put.
3. Increasing the frequency of use of commodities.
4. Lengthening the period or season during which the product is used.
5. Enhancing sales through
   a. Increasing the units of sale of products already in demand.
   b. Introducing new products to accompany the one already effectively advertised.

The accomplishment of a specific purpose is not attained under all circumstances. Different vendors utilize advertising with varying results. The interest that the seller may secure from the consumer in regard to his product varies from mere recognition of the product brand to an insistence upon the purchase of the particular product. The ideal of every manufacturer, of course, is that of creating such a regard for his product that his customers will *insist* upon his particular brand. If such were the result, he would enjoy a monopolistic control of the market. Actually, his success in achieving this result is only fair. Consumer interest shades by imperceptible steps from (1) consumer recognition, through (2) consumer preference, to (3)

consumer insistence. In goods that are essentially similar in character and that are made by a number of different manufacturers, the best any one manufacturer can hope for, often, is consumer recognition or preference.

Even consumer recognition increases the possibilities of sales, however, since the consumer upon being presented with a choice of several articles is often swayed in his purchase toward the one that he actually recognizes. The manufacturer who can develop a consumer preference to the extent of getting consumers to inquire for his good or brand still further strengthens his sales possibilities.[1] Consumer insistence, if and when it exists, yields the vendor even greater returns, since he not only is assured of a large sale volume but is able to exact tribute in the form of a monopolistic or quasi-monopolistic price.

In the sale of small items, which are constantly bought with little thought being paid to the purchase, consumer recognition, preference, or insistence can be maintained only by constant advertising. St. Jacobs Oil and Pearline are the classic examples of this among advertising men. Both obtained a wide sale a number of years ago through extensive advertising by their founders. In each case, however, when the properties were passed on to the heirs of the deceased founders, the latter decided the products were well enough known to continue to sell without the benefit of advertising. Each product was unsalable within a short time, and in each case the plant was eventually closed.

As has been suggested previously, the buying motives of consumers are a subject of constant study by advertising technicians. These motives, though many and varied, may be classified into two types, rational and emotional. Emotional motives—emulation, pride in

[1] In order to create a preference for an item of merchandise, one need not necessarily have an unique or even a superior product. In "My Life in Advertising" (pp. 101–103) Claude Hopkins tells the story of the successful Van Camp's beans advertising campaign: "Van Camp's offered no unique arguments. They were like other pork and beans. When we met in the factory and served a half dozen brands, not a man present could decide which was Van Camp's. But we told facts which no one else ever told. . . .

". . . We told just the same story that any rival could have told, but all others thought the story was too commonplace. . . . We could . . . bake better beans than any woman could ever bake at home [even though] we could not bake better beans than our rivals. So we centered our attack on the weak spots, made Van Camp's seem the one way out. And we created an enormous demand. Not only that, but *the Van Camp's brand commanded a much higher price than our rivals'.*" (Italics supplied.)

one's appearance, love of the romantic, social ambition—have their origins in human instincts where responses are unreasoned and impulsive. Rational motives, on the other hand, are based on reason and include such objective factors as economy in the purchase of goods and their durability.[1]

There is, of course, no basis for judging the relative importance of these appeals in personal selling. In the case of advertising, however, some idea of their relative importance may be gained by comparing the per cent of advertisements utilizing the two types of appeals. This Professor Copeland did some time ago for 668 advertisements in national magazines with the following results:

	Per Cent
Emotional	72.0
Rational	28.0
	100.0

Table 21 gives the results of a similar but somewhat broader study directed by one of the present authors. It can readily be seen from these data that in the sale of consumers' goods emotional appeals are

TABLE 21. ANALYSIS OF 800 ADVERTISEMENTS BASED ON APPEAL AND TYPE OF COPY IN DIFFERENT MAGAZINES, 1937*

Dominant appeal	Per cent	Type of advertising copy	Per cent
Emotional	86.0	Persuasive	85.0
Rational	14.0	Informative	15.0
Total	100.0	Total	100.0

* General, women's, movie, humor, class, news, business, parent, pulp, and social.

utilized much more extensively than are rational appeals. One might even infer from the figures that many advertisers believe that their products would not fare so well if judged by the consumer on a purely objective basis. And such probably is the fact. One can say, with little fear of contradiction, that advertisers do seek out the emotional foibles of the consumer and then play upon such weak-

[1] Other important motives, according to studies made by Dr. Melvin T. Copeland, are as follows: *Emotional*—social achievement, personal proficiency, maintaining and preserving health, proper care of children, satisfaction of appetite, security from danger, pleasure or recreation, and obtaining opportunity for greater leisure. *Rational*—economy in use, efficiency in operation or use, dependability in use or quality, enhancement of earnings.

nesses.[1] One must conclude, also, that the individual and social viewpoints are often in definite conflict; that advertising may "measure up" from the one point of view while dismally failing when measured in terms of the other.

The Social Viewpoint. Since the trend of expenditures for demand manipulation is steadily upward, the question whether such activities yield an advantage to society becomes particularly pertinent. One may even enquire whether demand manipulation may not actually operate to the detriment of society. The problem is an extremely difficult one, and the only hope of solution lies in analyzing this important force from a number of different socio-economic aspects.

One must continually bear in mind that nearly all sales effort is competitive in nature;[2] that a very large part is *purely* competitive. Much of this effort, in other words, is designed to draw trade away from a rival and to lead to the substitution of a particular concern's goods for those of a competitor. If goods and services are approximately equal in their capacities to satisfy the consumers' wants, successful effort in this direction probably leads to no immediate gain to consumers. There may be, however, certain subsequent developments arising out of this change of patronage that may very definitely affect subsequent consumers. It is contended, for example, that expansion (even at the expense of other firms) is good, since this results in a concentration of business in a smaller number of larger units and these larger business units will be able to operate at lower cost.

3. Advertising and Commodity Prices. Let us attempt an evaluation of sales-promotional activity and its effect upon prices.

[1] See Kenneth Goode, "Manual of Modern Advertising" (p. 433): "Speaking broadly, no advertiser who hopes to make a large success dealing with people in commercial quantities need waste a second thought on any motives except . . .

1. Self-preservation—This includes hunger and thirst.
2. Sex.
3. Emulation."

He argues further that the clever advertiser will stir the emotions of the prospective customer but will, at the same time, furnish him a basis for rationalization. Thus clever advertising psychologists discover that (p. 435) ". . . reasoning to justify an emotional decision, is very important . . . Even in penny chocolate bars, eaten for sheer pleasure, the thought of food value and energy can be utilized with profit. A blatant sex appeal page selling a cheap 'Doctor's book' in a popular magazine, drugs the reader's conscience with a final paragraph, 'What shall we tell our Growing Children?' "

[2] A. C. Pigou, "Economics of Welfare," 1st ed., pp. 172–175.

Advertising practitioners argue that advertising (and, indeed, any type of sales effort) increases sales volume, that this has the effect of decreasing production costs, and that, since costs decline, selling prices must necessarily follow. According to this contention, then, the effect of demand manipulation is that of reducing costs and, hence, prices.

In order to test this hypothesis it is necessary to refresh our memories with respect to certain aspects of our production system. It should be recalled that industries (or processes) may be classified into three types. These are known as industries of *increasing*, of *constant*, and of *decreasing* cost. *Increasing-cost industries* are those in which increasing unit costs may be expected to accompany an increase in volume. This phenomenon is due to the fact that in such industries (*e.g.*, in agriculture) the most important factor of production is one that is definitely limited. As this factor (land or other natural resources) is utilized more intensively (or as an increasing amount of an inferior quality is placed in production), the law of diminishing returns is brought into play and higher costs follow. Hence, an increase in demand can be satisfied only at an increase in unit costs.[1]

Industries are by no means always of the increasing-cost type. Some are said to operate in such a way that costs remain constant regardless of volume. So-called *constant-cost industries* are those in which increased demand can be satisfied with no change in unit costs. Theoretically such a condition can obtain when relatively little fixed capital needs to be utilized in the production process, when there is a plentiful supply of labor available at constant rates, when required raw materials are plentiful and freely reproducible, and when production methods are stable and unchanging.

Decreasing-cost industries, on the other hand, are those in which increased volume will be accompanied by a decrease in unit costs. There are several factors that may cause decreasing costs. One is

[1] There are, however, certain forces that counteract the tendency toward increasing costs. It must always be assumed in considering the principle of increasing costs that the state of the arts of production remains the same from one point of time to another. Remove this assumption, and labor and capital costs will perhaps be affected in such a way as to offset increasing tendencies. Again, prices of agricultural products, for example, are made up not only of production costs (in the narrow sense of the term) but of expenses arising out of processing and marketing. Each of the latter phases of activity might be of a decreasing-cost nature and thus might offset actual increases arising out of the increasing-cost phase of the production process.

the possibility of a more effective use of the production facilities accompanying large volume. The producer enjoying a large volume can utilize his plant and equipment more continuously and his management more fully. He can utilize specialized labor more effectively and can often buy fuel and supplies at lower prices as a result of volume purchases. Another factor, closely allied to the first, is the possibility of *adapting* existing technical equipment for use in the industry under question as production volume increases. The conveyor system (in existence years before the automobile industry came into being) could not have been effectively utilized, *e.g.*, by motor manufacturers, unless volume had been sufficient to utilize the device intensively. Diminishing returns in this type of industry, though not absent, usually remain latent until tremendous volume is attained. That is to say, in industries of the decreasing-cost type no one factor of production is definitely limited. Hence the effect of diminishing returns is postponed.

Since most manufacturing industries are of the decreasing-cost type, one is tempted without further analysis to give advertising a clean bill of health. In other words, it seems highly plausible that an increase in demand resulting from advertising in such industries would inevitably result in lower prices. But such a conclusion at this stage of the analysis is by no means tenable. When attempting to evaluate the social aspects of demand-manipulative effort and decreasing costs, one must consider, not one, but three questions.

1. Assuming some advertising effectiveness, how is the increased sales volume distributed among the several firms within the industry? For if advertising is effective only in increasing the sales of one firm as against another, a cost advantage to one may be offset by a disadvantage to another. Socially there may be no change arising out of such a shift in volume. The advertising of tire manufacturers seems to be largely of the type that succeeds only in increasing sales of one company at the expense of another, since the demand for tires is a derived demand. Ordinarily one is not influenced by advertising to purchase a new set of tires, although one may indeed be influenced to buy the product of a certain manufacturer when one's old tires are worn. Gasoline is probably in the same category. Other examples should suggest themselves. In these products advertising probably serves only to increase costs to consumers.

Advertising might indeed be effective in increasing the sales in a whole industry, however. If so (and if optimum size were not already attained), one might expect a reduction of costs in the several plants

in the industry. Even in the absence of a general increase, advertising effectively utilized may actually concentrate production in the hands of a relatively small group with a resultant cost advantage to the individual firms constituting the group. Without advertising, in other words, there might exist hundreds of small plants, each serving its own local market. Publicity on a national scale extends markets and makes for larger sales volume and hence operations on a larger scale. In this way, the level of costs may be forced downward also.

2. Is the industry actually one of decreasing costs? If not (at least, if a part of the total production process is not of the decreasing-cost type), then increased volume coming about as a result of demand-manipulative activity obviously cannot be expected to bring about decreasing costs. Indeed, increased volume might actually raise instead of lower costs. In such a case, clearly, lower prices do not accompany increased volume.

As has been suggested previously, however, the principle of decreasing cost may actually operate in certain phases of an increasing-cost industry. It would be possible, in other words, to have decreased cost result from increased volume even in certain phases of extractive industries. Decreasing costs might even more than offset increasing-cost tendencies. Lumbering may be considered as an example of an industry of this type.

3. Are the savings coming about as a result of lowered costs passed on to the consumer in the form of lower prices? This introduces the whole question of advertising or brand monopolies. Prices, instead of being decreased as a result of an effective advertising program, may indeed be increased. There is no doubt whatever that in practice a differential gain accrues to companies whose sales-promotional programs are successful enough to establish the name of their products in the minds of consumers.[1] Although the total amount of such gains

[1] For example, a study by E. T. Grether of the University of California some time ago revealed that the annual net profit of the Lambert Company, manufacturer of Listerine, was almost nine times the value of the physical property of the company; that the Coca-Cola interests, whose tangible assets were worth some $5,000,000, were acquired by a banking group for a sum approximating $25,000,000; that the William Wrigley Company had at the time a balance of $9,000,000 available for dividends, with assets of $43,000,000 and physical property of only $10,750,000; and that Lehn and Fink paid $6,250,000 for intangibles. Although there is no way of separating the effects of advertising from the effects of product quality, good management, and merchandising methods, the effects of advertising cannot be gainsaid. Besides the higher

does not arise out of lower costs resulting from increased volume, some part, no doubt, does. Part, of course, comes from the quasi-monopolistic prices that can be exacted by such companies.[1] Regardless of the specific source of the differential, however, the result is inimical to the interest of the consumer. Advertising in such cases (even though the industry be one of decreasing costs) is antisocial, since the consumer, instead of receiving a portion of the gains resulting from advertising in the form of lower prices, is actually paying a penalty in the form of higher prices.[2] That is, the consumer is penalized when he responds to the importuning of the advertiser to "insist on the genuine!" Brand dominance occurs most often in convenience and specialty-goods lines; less often in the sale of shopping goods; very seldom in the industrial field.

It should not be surprising, in the light of the foregoing discussion, to find that the sensitivity of advertised merchandise prices and non-advertised commodity prices varies greatly; that, according to avail-

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price that can be exacted from consumers (even for products whose qualities are absolutely indistinguishable from those of competitors), the following other differential gains may result: (1) Companies may be able to command the services of dealers at a lower margin. (2) Other products of an allied nature may be more effectively sold by trading on established good will. (3) Such producers are partly protected from competition by newcomers since potential competitors are faced with the prospects of expending huge amounts of effort and money in order to earn a place in the sun.

[1] The following price and cost data based upon analyses made by the Bureau of Health of the State of Maine and reported in Ruth de Forrest Lamb's "American Chamber of Horrors" (pp. 339–349) are, perhaps, somewhat typical of the price situation obtaining in the field of highly advertised cosmetics:

Item	Approximate cost at retail	Selling price
Coty dusting powder	$0.1570	$0.75
Elizabeth Arden Venetian lip paste	0.0240	1.00
Harriet Hubbard Ayer special astringent	0.0884	1.75
Evening in Paris perfume	0.2680	2.75
Luziers' Lu Mar (massage cream)	0.1404	3.00

[2] It must be admitted that the *level* of prices, even in such cases, may decline as a result of large volume since brand monopolies are incomplete. The point is, however, that because of their enjoyment of a quasi-monopolistic control the producers of products which are in particular favor need not pass on *all* of the volume savings. They may, in other words, charge prices which are somewhat higher than those which would exist at the competitive level.

able evidence, prices of manufacturers' heavily advertised goods are relatively "sticky" in periods of falling prices.

Table 22 presents index numbers of prices of all foods and of advertised grocery items as reported by one corporate chain concern. For one thing, the table indicates that there is a slower decline in advertised than in the general grocery price list; the all-inclusive mer-

TABLE 22. INDEX NUMBERS OF ALL FOODS AND OF ADVERTISED BRANDS AS REPORTED BY ONE CORPORATE FOOD CHAIN FOR SELECTED DATES—OCTOBER, 1929 THROUGH DECEMBER, 1938*
(October, 1929 = 100)

Time	All foods†	Advertised grocery items
October, 1929	100	100
December, 1930	84	95
December, 1931	75	90
December, 1932	66	85
February, 1933	62	75
December, 1933	70	80
December, 1934	76	85
December, 1935	84	87
December, 1936	83	87
March, 1937	82	88
March, 1938	75	86

* NEIL H. BORDEN, "The Economic Effects of Advertising," Irwin, 1942, p. 600.

† Including advertised items, perishables, and meat and grocery trading items (such as butter and flour, whose prices are governed largely by fluctuations in basic commodities).

chandise price index had declined to 75 by December, 1931, from the beginning of the depression in October, 1929, while that representing prices of advertised merchandise did not reach 75 until February, 1933, over a year later. Moreover, if we may rely on the evidence of the table, the amount of the price decline was smaller in the case of advertised merchandise as compared with the nonadvertised commodities (the lowest point reached was 62 in February, 1933, for all foods, while the lowest price for advertised items was reached at the same time but stood at 75). It is interesting to note the effect of the recession of 1937–1938: the index for all foods dropped from 82 to 75 from March, 1937, to March, 1938, while the decline was only from 88 to 86 for grocery advertised brands during the same period.

Evidently prices for advertised brands are "sticky" not only on the downswing, but on the upswing also, although this tendency is somewhat less marked. The rise from February, 1933, to December,

1935, the low point for all foods, was from 62 to 84—22 points—while the rise for advertised brands was from 75 to 87—12 points. That is to say, while in February, 1933, there was a difference of 13 points between the two indexes, by December, 1935, the difference had narrowed to only 3 points.

To summarize, then: In analyzing the effect of advertising on prices, one needs to inquire into (1) the effect of the advertising—whether increased sales accrue to the entire industry or to one producer at the expense of others; (2) the type of industry—whether it is one of increasing, constant, or decreasing cost; and (3) the disposition of the product of increased efficiency—whether the consumer actually is given the benefits or whether, on the other hand, efficiency savings are retained in the form of profits by the firms effectively utilizing the sales-promotional device.

The prices of many advertised products have been reduced over a period of years, or during periods of rising prices have increased less rapidly than prices generally. One can mention scores of instances, automobiles offering an outstanding example. A great deal of the cost (and price) reduction in such cases, however, has resulted from inventions and improvements in technical skill—many of which could have been utilized with no great increase in sales volume. In other words, some of the reductions in costs appearing in so-called *decreasing-cost industries* have probably had little connection with increased sales volume. One must distinguish cost reductions that are functions of increased volume from those resulting from extraneous causes.

Advantages accruing to industry as a result of increased volume are not limitless in any case. Not only does the decreasing-cost line tend to level off as volume increases (due to an eventual attainment of optimum size), but additional offsetting factors come into being as well. "(1) The purely supervisory staff increases more rapidly, after a time, than does output. (2) The relations between different departments and plants become more complex and more likely to involve misunderstandings. (3) The number of regimenting rules and regulations, the red tape, becomes greater and leads to increased cost and to inefficiency. (4) Lack of a feeling of responsibility and a growth of evasion of responsibility also make their appearance in organizations beyond a certain point."[1]

4. Advertising and the Business Cycle. It has been argued by advertising protagonists that demand manipulation is a valuable economic tool since it has the power to smooth out cyclical move-

[1] F. B. GARVER and A. H. HANSEN, "Principles of Economics," rev. ed., p. 235.

ments in business. If the contention has merit, advertising is, indeed, of tremendous social value. Certain studies of this phase of advertising have been made,[1] but because of an absence of sufficient factual data the results are still somewhat inconclusive. Though it can be demonstrated that there is a correlation between advertising and sales volume in individual instances, the various causes of such phenomena cannot be isolated. If one compares advertising appropriations and sales, one may find in certain instances that firms which increase their appropriations enjoy an increase in sales and those which decrease their appropriations suffer a decrease in sales. There are, however, certain limitations to the inferences that may be drawn from such findings:

1. There is no way of determining which is cause and which is effect. In other words, the question remaining unanswered is, Do increased sales follow increased appropriations, or vice versa?

This question must be seriously considered, since many firms base their advertising appropriations upon past or prospective sales volume. Though some sales undoubtedly result from such expenditures, the increased expenditures, made as they are on a basis of enhanced volume (resulting from a combination of causes), are artificially controlled, thus making for a possible spurious correlation between sales and advertising.

2. The effect of advertising in time of depression might well be (and probably, in many instances, is) to increase sales of one company as against those of another, having no effect on the industry as a whole. It has been demonstrated often that one firm can improve its position in an industry even in the face of declining sales for the industry as a whole. The result in such a case is an advantage to one firm at the expense of another and is probably of little value in ironing out cyclical fluctuations except from a purely individual point of view.

3. The type of commodity probably has a great deal to do with the potentialities of advertising as a stimulus to sales in time of depression. In a study made by the University of Minnesota[2] in 1933 it was found that though food production in the United States had decreased only 11 per cent and textiles 13 per cent, and though tobacco production had actually increased some 13 per cent from the beginning of the depression, the production of iron and steel, lumber products, and machinery and metals had decreased by 52, 71, and 74 per

[1] See particularly R. S. Vaile, "Economics of Advertising," Chap. VI.

[2] R. S. Vaile, ed., "Impact of the Depression."

cent respectively. This is typical of the contrasting effect of the depression on consumption and capital-goods industries. It can be seen readily that the type of industries needing stimulation in time of depression are the so-called heavy industries. And these are the industries in which advertising can least effectively be used. Imagine, for example, the U.S. Steel Corporation launching a campaign to "use more steel," or—equally ridiculous—some large machinery-

TABLE 23. INDEX OF VOLUME OF ADVERTISING IN THE UNITED STATES, 1929–1941*
(1929 = 100)

Year	Index of advertising	Year	Index of advertising
1929	100	1936	73.8
1930	86.1	1937	77.9
1931	73.3	1938	67.5
1932	58.6	1939	68.8
1933	53.1	1940	70.1
1934	61.8	1941	74.1
1935	65.7		

* Adapted from *Printers' Ink* Combined Index 1936 and 1942 Supplements, *Survey of Current Business*, pp. 21 and 29, respectively.

manufacturing concern placing its trust in advertising when owing to general industrial inactivity prospective customers are utilizing their plants at, say, only 50 per cent of capacity. The fact is that under these conditions no inducement (let alone advertising!) would be effective in the sale of such equipment.

The authors can see little in the argument that advertising can help very much in ironing out cyclical fluctuations in business. Indeed, the figures in Table 23 indicate that businessmen themselves have no overabundance of faith in advertising in time of depression.

5. Truth in Advertising. That much advertising is not strictly truthful there can be little doubt. As has already been indicated, advertisers use every known appeal in seeking custom for the products offered consumers. Some advertisers create a false sense of danger ("impure" toilet tissue); others, a false sense of security (weak antiseptics); in fact, many of our present-day plagues are products of the imagination of some copy writer. Acid indigestion (Phillips' milk of magnesia), body odor (Lifebuoy soap), coffee nerves (Kaffee Hag), cosmetic skin (Lux soap), smokers' teeth (Bost toothpaste), intestinal fatigue (Fleischmann's yeast), paralyzed pores (Lady Esther face cream), and intestinal toxicity (Eno Salts) are a few of the many

"diseases" discovered, if not invented, by the advertising fraternity. Nor is that all. Advertising at times makes possible the sale of deleterious nostrums which are dangerous either directly or indirectly. That is to say, dire results may actually follow their use, or by reason of their therapeutic worthlessness, the users who attempt self-diagnosis thus forego sound medical advice until it is too late.

Untruthful advertising is by no means a new phenomenon.[1] In fact, advertising is not nearly so mendacious now as heretofore. As a result not only of group effort on the part of the advertisers but also of governmental regulation,[2] serious misrepresentation is on the wane. Much advertising even now is "puffed," however. Hence each advertiser's product is *the best, the most durable, the greatest value,* and

TABLE 24. PERCENTAGE OF TRUTHFUL, UNTRUTHFUL, AND PUFFED ADVERTISEMENTS IN 10 DIFFERENT TYPES OF MAGAZINES, 1937*

Degree of Truth	Percentage
Apparently truthful	34.0
Puffed	48.0
Untruthful	11.0
Indeterminable	7.0
	100.0

* General, women's, movie, humor, class, news, business, parents, pulp, and social.

what not. Table 24, based upon a study of 10 different types of magazines, indicates (according to the opinion of the investigator) that while only 11 per cent of the advertisements analyzed were out-and-out untruthful almost 50 per cent were puffed.

Consumers are not the only ones who look upon untruthful advertising with disfavor. Thoughtful advertising men abhor this type of advertising, at least theoretically, on the grounds that the effectiveness of all demand-manipulative effort is undermined by the untruthful statements of a few. The reason is apparent. The effectiveness of advertising depends upon the faith of the consumers. If their faith in advertising declines, the guiltless suffer with the guilty. In

[1] One could cite scores of examples of untruthful advertising down through the years. A particularly interesting one published in 1657, a facsimile of which appears in Frank Presbrey's "The History and Development of Advertising" (p. 49), holds forth in the following fanciful way on the virtue of coffee as a drink. "It suppresseth Fumes exceedingly, and therefore good against the *Head-ache* and will very much stop and *Deflection of Rheums,* that distil from the *Head* upon the *Stomach* and to prevent and help *Consumption,* and the *Cough of the Lungs.* It is excellent to prevent and cure Dropsy, Gout and Scurvy . . . [and] *to prevent miscarryings in child-bearing women.*"

[2] See Chap. VII.

general, if advertising is ineffective the sums thus ineffectually expended are a social waste.

6. Advertising as an Informational and Educative Device. There is a tremendous contrast between advertising as it could be and advertising as it actually exists. That is to say, advertising has tremendous potentialities which are not fully realized. Advertising informs the consumer at times but misinforms him at others. Education connotes the teaching of the truth. Advertisers not only are biased but also lack the social responsibility of true educators. It seems very unfortunate that advertising cannot do a completely satisfactory job of informing, because the consumer in our present society has great need of informative news concerning the offerings of vendors. In other words, the consumer is a specialist, often making nothing that he uses directly; hence, he requires truthful information as to goods and services that are available to him. As a matter of fact, the consumer's reliance on information supplied by advertisers is quite essential because that very fact—the knowledge that information concerning goods will be available—makes it possible for him to practice specialization of effort.

One should not conclude that advertising is not at all educative. "There are . . . certain ways in which advertising might be educative —and doubtless sometimes is. The principal possibilities may be listed as follows:

"1. Methods of use of product, including its own care and upkeep.

"2. Announcement of new products, new inventions, new processes.

"3. Announcement of new uses for old products and of [product] improvements.

"4. Announcement of a product to a market where it has not previously been available.

"5. Announcement to a constantly changing public, *i.e.*, the people who are just becoming old enough to make use of a product.

"6. Listing of the place and explanation of the method of purchase and sale.

"7. Information concerning [prices], stocks on hand and tendencies in supply and demand.

"8. [Announcement of] Style changes and trends.

"9. The popularization of a new custom as a part of the standard of living.

"10. [The furnishing of] Objective measurements of performance."[1]

[1] Vaile, "Economics of Advertising," pp. 45–46.

As has been suggested, most of these possibilities actually are utilized by advertisers at one time or another. Informative (in contradistinction to persuasive) advertising undoubtedly increases the degree of perfection of the market by improving the position of the ordinarily uninformed or poorly informed consumer-buyer. Indeed, in a society based upon specialization the dissemination of information through advertisements is absolutely essential.

Advertising of the purely informational type then is not completely absent in our economy. Want advertisements, for example, are usually essentially informative, as are the descriptions of merchandise appearing in mail-order catalogues. Indeed, retail advertising in general is, to a considerable extent, informative.

This is particularly true in the grocery field where mass distributors, at least, publicize their offerings regularly, presenting mainly factual information on the items offered and their prices. There is, of course, still much room for improvement. It is encouraging to note, however, that more sound information is being given consumers in retail advertisements than heretofore.[1] Still more can be expected in the future.

7. Advertising and Living Standards. It is sometimes argued that advertising raises standards of living. There can be little quarrel with the statement if the word *affects* may be substituted for the word *raises,* and none, certainly, if the term *consumption* is used in place of the word *living.* It is assumed, of course, that one actually means that *standards* rather than *scales* of living or consumption are affected by advertising. One can hardly dispute the contention that advertising along with many other environmental factors has marked

[1] As an example of a genuinely objective advertisement, the following specimen is submitted:

"Lady Pepperell Sheets & Cases

Tubtested by the makers of Rinso, Lady Pepperell sheets, after 200 washings (equivalent to eight years' normal wear) emerged snowy white and almost as sturdy as new. See how they compare with U.S. requirements for high count sheets":

Type	Weight per square yard, oz.	Thread count warp filling	Breaking strength, lb.	
			Warp	Filling
U.S. government.........	4.3	69 62	65	60
Lady Pepperell..........	5.6	76 68	75	95

influence upon the creation and strengthening of *desires* for more and better worldly goods.

It is probably even true that advertising affects *scales* of consumption. There are several possible ways in which it does so. (1) If reduced prices do actually result from larger sales volume (coming about as a result of advertising), consumers are enabled to buy additional goods with the resulting savings. (2) In cases where advertising actually increases volume, it is (at least theoretically) possible that part of the efficiency savings resulting from such increases would be passed on to workers in the industry so affected. In other words, volume operations made possible by effective advertising expenditures may bring efficiency differentials, part of which may be distributed to workers.

(3) By virtue of their increased desire for worldly goods (brought about, in part at least, by advertising), workers may strive harder and thus produce more.[1] There is little question that such a tendency eventuates in some instances. The commission salesman and the pieceworker, for example, may strive harder and achieve a higher living scale as a result.

(4) But probably the fourth possibility is the most effective, that of limiting the size of the family, although it should be emphasized that we are *not* discussing a method of achieving happiness. As was stated previously, individuals are influenced by various environmental factors (including advertising) in the establishment of certain standards of living. They are able to achieve a higher scale per individual family member by the simple expedient of limiting the number of individuals making up the family group. Hence the average American influenced by advertising chooses to forego the large family in order that he may acquire more or better worldly goods.

There is little doubt that advertising (either directly or indirectly) affects both standards and scales of living. Each of the aforemen-

[1] Quite pertinent in this connection is this story: An American—a cigarette manufacturer operating a factory in Mexico—was faced with a serious employee-absentee problem. He discovered that his workers—mostly girls—would work for a few days, then "feeling wealthy" would take a few days off. He discovered, in other words, that their wants were simple and were easily satisfied as a result of working a few days out of each week. He solved the problem by picking out the prettiest girl in the factory, presenting her with a pair of silk stockings, and explaining that each worker would be given a similar gift if her attendance were regular. By offering portable phonographs and other luxuries, subsequently, he succeeded in raising their living standards to such an extent that steady work became essential to those wishing to maintain the standard thus established.

tioned modes of influence has some validity. The last—limiting the size of families—has probably the greatest significance as a device for providing more goods and services per family member.

8. Final Criticism. Though all advertising cannot be condoned, certainly all cannot be condemned. Theoretically, at least, "... any occupation or undertaking is productive if it adds to the utility of consumable goods either by increasing the units of goods possessing want-satisfying qualities or by increasing the utility of individual units. . . . [By this standard of measurement, advertising] may at times be (1) destructive, (2) neither destructive nor productive, (3) less productive than some other combination or approach would provide, or (4) more productive than any other combination or approach. . ."[1] The student will recognize the fact that some types of advertising will fall into one category whereas other types may fall into an entirely different classification. The use of advertising to disseminate information to the medical profession concerning the use of sulphanilamide in the successful treatment of streptococci infections is of definite social advantage; the use of advertising in the sale of pornographic literature is socially disadvantageous.

When one invokes a strictly economic test—the effect of advertising upon prices—one must be equally eclectic. Increased sales brought about by the medium of advertising may raise or lower prices, depending upon the circumstances. The statement made by advertising men that advertising pays for itself through cost and price reductions is not completely tenable. The incidence of advertising costs depends upon the type of production operations obtaining in the industry, the distribution of increased volume among the several plants in the industry, and the extent of the monopolistic power built up and exerted by the advertisers.

It must always be borne in mind, however, that (if, indeed, we are to condone *any* sales effort in our economic system) advertising may aid in accomplishing a selling task at a lower cost than if personal sales effort were utilized exclusively. There are at least two ways in which this may be brought about. (1) By utilizing the device for economically seeking out prospective buyers or sellers. For example, retail advertising has as its major purpose the bringing of prospects to the market place so that the sales task may be completed by salespeople; a salesman selling some household device from door to door may advertise that he will be glad to demonstrate the device if interested persons will telephone or drop a card; a bibliophile in searching

[1] C. H. Sandage, "Advertising—Theory and Practice," p. 19.

for a book long out of print may save much time, effort, and money by indicating his requirements in the columns of *Publishers' Weekly*. The end in each of these cases is the same—that of bringing buyers and sellers together. (2) By supplying information to, and reducing sales resistance of, prospective purchasers so that the costly time of the salesman may be saved.[1] In other words, if the prospective buyer can be partly "sold" by means of advertising, the time taken by a salesman who calls subsequently will be materially reduced, thus cutting down the cost of selling. In the sale of consumers' goods to dealers, moreover, the latter are more apt to buy the well-advertised commodity if they know that the consumer, in turn, will be amenable to suggestion and thus more easily "sold."

[1] As many now know, producers tend increasingly to make studies of consumer reactions to particular names of products and various consistencies, qualities, and styles of merchandise, with a view to offering the consumer articles that will be acceptable to him. Thus, many companies do not add products to their line or change the formula or packaging of those already offered without consulting consumer buyers by some sort of sampling procedure. One company, typical of others, has a research department which employs field representatives in various cities throughout the country in much the same way as Gallup does in the political field. These field people consult with consumers—selected on a basis of representativeness of the market for the item under consideration—on matters of consumer preference and actually place in their hands various samples of products manufactured according to this formula; the company is governed in its actions by the results of such studies. The sampling device is thus utilized in many fields. (See RALPH CASSADY, JR., Statistical Sampling Techniques and Marketing Research, *J. Marketing*, Apr., 1945, pp. 317–341). Advertising testing is predicated on much the same basis, although most often sampling procedures are not as elaborate. The purpose here is to find the type of appeals that will cause consumers to respond to the advertising message.

There are two aspects of these increasingly common techniques which should be examined from the consumer point of view:

1. The consumer at least is being consulted (albeit by proxy) as to his preferences, so that his chance of getting the kind of merchandise he prefers tends to be better than if he were not consulted. Thus, he is apt to find that his quick oats have a better flavor, his movie stories are more to his liking, and his ladies' dresses are more attractive than if the device were not employed.

2. On the other hand, the producer, as a result of such studies, has greater knowledge of consumer reactions than he would have otherwise, so that market imperfections are increased; that is, such studies intensify the already poor balance between consumer knowledge and producer knowledge. Thus, the consumer is more susceptible to exploitation. This is likely to be particularly true in oligopolistic situations where a "sticky" price condition is to be expected anyway.

Advertising testing, whose purpose is to predetermine the responsiveness of consumers to the appeal of an advertisement by some consumer selection process

There is little question as to the general effectiveness of advertising in the sale of individual commodities, although, as was suggested previously, results differ with circumstances. For some products (cancer "cures," for example), this sales-promotional device is in fact much too effective. For others (industrial items in time of depression) advertising is probably quite ineffective. That consumers read retail advertisements there is little doubt.[1] That they actually utilize the advertisements as a guide to their purchasing is equally certain.

It should be recalled finally that ours is a modified capitalistic economic system based upon private property rights and freedom of individual enterprise. This means that the system depends upon competition, and advertising is just one of the many methods used by sellers in their competitive struggle. Although there are admittedly certain devices in the competitive system that seem wasteful, the system taken as a whole is thought to be more economically effective than others. We must, in some instances, therefore, accept apparently

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or by actual tryout conditions, is in some ways more disadvantageous from a consumer point of view than commodity-preference studies. The reason for this lies in the fact that the consumer advantage connected with the former is not present in the latter and the disadvantage present in both is intensified. That is, one is not likely to get an advertisement that fits his needs through such studies, as in the case of commodity testing, but will be exposed, rather, to the type of advertisement that the producer finds will be most effective in causing him to respond. Thus, if, by advertising testing, fear is found more likely to move a person to purchase more life insurance from the X company than love of family, the former will be utilized. Technically speaking, the result is that the market is less perfect than before because vendors have increased knowledge of purchasers' reactions, while purchasers do not gain corresponding knowledge of sellers' offerings. Actually, when this superior knowledge on the part of producers is applied to the selling task, the consumers may lose sight of what little information they possess.

From the standpoint of society there is one offset to the foregoing disadvantage which should be mentioned. As stated elsewhere, waste in advertising, as in anything else, cannot be condoned. Therefore, if selling effort is wasteful as a result of being ineffective, and is ineffective because of insufficient knowledge, something can be said for a device which supplies this knowledge. Moreover, perhaps the consumer should be charged with the responsibility of informing himself about producers and their offerings, just as the producer does about consumers and their preferences (see pp. 356–360). If this is done, then information is increased on both sides of the market and, other things being equal, sharper competition is likely to result, with consequent downward pressure on prices.

[1] Retail advertising is of particular interest to the consumer. In a study by Harold A. Fry ("A Study of Customer Opinion of the Advertising of Toledo

undesirable phases of a superior system because they are part of that system.

Nor should advertising be totally condemned simply because it is being misused. The writers submit, however, that advertisers should lay more stress on objective performance and less on an appeal to the emotions, that the advertising fraternity should see fit to raise its standards of ethics and taste, and that certain types of advertising should be legally proscribed. But as long as competition is the core of our system, advertising will be used by vendors to strengthen their own position in the market. Instead of condemning the device, then, we should be thinking in terms of raising advertising standards and where necessary circumscribing its use.

Questions

1. Compare in the current magazines the advertisements of various companies for a similar product such as toilet soap, face cream, or cigarettes. Are the claims essentially similar? What factual information is given? Could the product be recognized from the advertising if the name were deleted?
2. The cooperative creameries in Minnesota advertise butter, securing their funds by a deduction from the cream checks of their farmer patrons. Are the farmers wise to support this movement? How does such a program affect the consumer?
3. In what fields has advertising been relatively successful? Where unsuccessful? Give the reasons for your answer.
4. What relationship, if any, is there between advertising and the elasticity of demand for a commodity?
5. Is advertising ever directed to any other purpose than securing a monopoly?

Retail Merchants," University of the City of Toledo) it was found that the reading habits of the consumer were as follows:

Read retail newspaper advertisements	Percentage of men	Percentage of women
Daily	60.3	79.0
Thrice weekly	7.3	4.4
Twice weekly	5.9	2.2
Once weekly	11.8	4.9
Occasionally	4.4	1.7
Very seldom	4.4	1.7
When making specific purchases	4.4	4.4
Miscellaneous answers	1.5	1.7
Total	100.0	100.0

6. Would an advertising-less society be to the advantage of the consumer? Discuss fully.

7. Are there any types of advertisements that materially aid consumers in their purchasing activities?

8. Is advertising more or less important in an authoritarian than in a free society? Explain fully.

9. According to data presented in *Tide* (Aug. 23, 1946, p. 17), advertising expenditures for Philip Morris cigarettes in magazines, newspapers, and on the radio increased from several hundred thousand dollars in 1933 to $3,500,000 in 1945; during the same time sales increased from an almost negligible figure to 27 billion cigarettes and fourth position in the industry, presumably as the result of this sales effort. Discuss this case from the point of view of social desirability, assuming a free competitive system. Would you alter your views if we were to assume that fundamental changes could be made in our economic society?

10. What do you think would happen if any one of the cigarette companies stopped advertising? Explain.

11. The wine industry seems to be an example of one in which first one firm and then others have instituted intensive advertising programs during the past several years. With the aid of the "Readers' Guide to Periodical Literature" prepare a paper on the results of this program (*a*) to individual firms and (*b*) to the industry as a whole.

12. Does advertising have the effect of intensifying or of vitiating competition? Explain in detail.

13. It has been argued that advertising is justified if only because the end product of our economic system is consumer satisfaction and that advertising intensifies consumer satisfaction. Do you agree?

CHAPTER XII

STUDIES OF FAMILY EXPENDITURES

We are able to gain some information on the manner in which families spend their income from studies of family expenditures. There have been a great many of these studies made, both in this country and abroad. They can seldom be directly compared. They have been made in many different ways and include families living under quite different circumstances. Moreover, the families included in the studies have usually been selected in a particular manner and for a particular purpose and may not be representative of the community as a whole. When the data from these studies are arranged in certain forms, however, there is marked similarity among them. This similarity appears most strongly in the proportions of the income expended in various lines of expenditure as the incomes become larger and the changes in the proportions of the income expended in various lines of expenditure as the family changes in size. We may be quite sure of our conclusions in these respects, since they appear in all the data except for families at or below the subsistence level.

1. Some Early Studies. Some of the studies of family expenditures are quite old. Sir William Petty, for example, in 1672 used estimates of the purchases of the average workingman's family in judging the possibilities of trade with Ireland. David Davies, an English clergyman, in 1795 published data on the living of families of 137 agricultural laborers from various sections of England, Wales, and Scotland.[1] He endeavored to learn why two-fifths of his parishioners were receiving aid from the parish. Another early English study was published in 1797 by Sir Frederick Eden,[2] who was anxious to prove that in years of distress which attended the high price of corn, increases in the poor rate were not necessary. None of these early studies used statistical analysis or generalizations.

About 1850, extensive development of expenditure studies along two sharply different lines began. These were individual case studies of the LePlay type and statistical studies of selected groups of families.

[1] "The Case of Laborers in Husbandry."

[2] "The State of the Poor."

Frederic LePlay was a French mining engineer who spent his vacations living with typical families in various parts of the world. These families were carefully selected after consultation with local clerical, educational, or other authorities. LePlay then lived for some weeks or months with each of them, and his monographs[1] present in minute detail the facts regarding the financial and domestic conditions both past and immediate of the particular family. The reports are so exhaustive and so remarkably well done that even now one can secure a vivid impression of the circumstances and manner of life of these individual families. The method has subsequently been followed by other investigators.[2] This method of careful observation of selected cases is valuable only when the cases are typical and the investigators are highly skilled. These conditions are rarely found, and more reliance is to be placed generally upon other methods.

The first use of what may be termed the *statistical method* in expenditure studies was made by Ernst Engel in 1857.[3] Engel was then head of the Statistical Bureau of Saxony. His contributions were in the classification of expenditures under systematic headings, arranging families by income levels, averaging the family totals for each item of expense at each income level, and getting expenses per capita for each heading and then translating these average figures into the form of percentages of total expenditures.

2. Studies in the United States. There are more than 450 known studies of family expenditures in the United States. They have been made by many different investigators, for dissimilar groups and by such a variety of methods that comparisons among them are difficult. The most extensive studies have been made by the U.S. Bureau of Labor Statistics or by it in conjunction with other Federal agencies. There have been four investigations covering a large number of families in different states. The first was in 1889–1890, of 6,809 families connected with certain industries in which there was international competition. The second, in 1901, included 25,440 families distributed in various geographical divisions of the United States in relation to the industrial population. A third study made in 1918 included 12,096 white families located in 92 industrial centers. The last study, the Consumer Purchases Study made jointly by the Bureau of Labor Statistics and the Bureau of Home Economics, is the most elaborate ever undertaken. It was made in 1935–1936.

[1] "Les Ouvriers europeens," 1855–1879.

[2] See "Studies of Family Living in the United States and Other Countries," *USDA Misc. Pub.* 223.

[3] "Produktions, und Konsumptionsverhältnisse des Königreichs Sachsen."

For the Consumer Purchases Study a preliminary short schedule was obtained from a random sample of about 336,000 families. A longer schedule covering information on expenditures and savings during the year, ownership of important types of durable goods, and other aspects of consumption was secured from a controlled sample of some 53,000 families drawn largely from the random sample. Records were secured from urban groups in cities of various sizes and from village and farm groups in various types of farming areas. Seven occupational groups, 20 income classes, and 5 family types are also distinguished and records secured from each. Certain budget groups have been examined for a smaller number of families. For example, special records of food consumption were secured from about 3,000 families to study the nutritional adequacy of the diet. For these families records were kept for one week at each season during the year. They were accompanied by records of the incidence of sickness of the members of the family in order to make possible an analysis of the relation of diet and health. This study provides more complete data on family expenditures in the United States than any heretofore available.

In addition to these studies there have been a great many others made both by the Bureau of Labor Statistics and by other agencies. One of the earlier important studies made by other agencies is the so-called Chapin Report on the standard of living in New York.[1] The report was published in 1909 and included 400 family budgets which were excellently analyzed. The Chapin study probably received as much attention as any study since the time of Engel. Another important study was a national survey of the cost of living in the United States made by the Board of Trade of Great Britain in 1909, covering 7,616 families in 29 cities and dealing principally with food and shelter. The same method of conducting surveys was used by the Board in surveying living costs in Great Britain, Germany, France, and Belgium. This material makes possible some sort of international comparison.

3. Trends of Expenditure. When the expenditures of families of essentially similar composition and location, but with different incomes, are examined, it will be found usually that the higher income families spend more on each of the principal expenditure groups than do those with lower incomes. A typical example for city families is given in Table 25 from the 1934–1936 study of the Bureau of Labor Statistics.

[1] R. C. Chapin, "The Standard of Living among Workingmen's Families in New York City."

TABLE 25. AVERAGE EXPENDITURES OF CITY FAMILIES WITH DIFFERENT INCOMES IN THE UNITED STATES, 1934–1936*

Income	Average annual current expenditure							
	Food	Clothing	Housing	Fuel, light, refrigeration	Furnishings and equipment	Automobile	Miscellaneous	Total
$500–$600	$273	$50	$160	$72	$12	$14	$155	$736
600– 900	323	74	175	77	28	21	173	871
900–1,200	401	102	217	94	39	41	222	1,116
1,200–1,500	473	136	246	106	55	74	282	1,372
1,500–1,800	541	173	281	114	70	100	351	1,630
1,800–2,100	597	211	300	122	77	137	428	1,872
2,100–2,400	683	258	324	136	89	162	507	2,159
2,400–2,700	756	308	345	132	96	162	616	2,415
2,700–3,000	837	388	370	131	83	196	698	2,703
3,000 and over.....	1,022	472	408	148	113	213	843	3,249
All incomes	515	163	262	109	61	90	336	1,536

* Adapted from *U.S. Bur. of Labor Statistics Bull.* 638, "Money Disbursements of Wage Earners and Clerical Workers, 1934–1936."

Some of these increases are more rapid than others, with the result that, when families are arranged according to income level and the individual expenditure groups are expressed as percentages of either the total expenditure or the income, certain well-defined trends are disclosed. These are shown in Table 26 for the families whose actual expenditures are given in the preceding table.

Some studies express the expenditures as proportions of the total expenditure, others as proportions of the total income. There is little difference in the case of the lower incomes, where the savings are small, but for the larger incomes quite a difference may arise, and a more accurate picture of the larger incomes is obtained by expressing the relations in terms of total income. The majority of expenditure studies have reference to the smaller incomes. There are very few data on the expenditures of the large incomes.

The rates at which expenditures on a particular item or group change are of importance. The relationship may be expressed by a coefficient and is termed the *elasticity of consumption*. The size of this coefficient may be taken generally as indicative of the relative urgency of consumption of the item or group. The higher the elas-

TABLE 26. PERCENTAGE DISTRIBUTION OF EXPENDITURE OF CITY FAMILIES WITH DIFFERENT INCOMES IN THE UNITED STATES, 1934–1936

Income	Food	Clothing	Housing	Fuel, light, refrigeration	Furnishings and equipment	Automobile	Miscellaneous	Total
$500–$600	37.1	6.8	21.8	9.8	1.6	1.9	21.0	100
600– 900	37.1	8.5	20.1	8.8	3.2	2.4	19.9	100
900–1,200	35.9	9.1	19.4	8.4	3.5	3.7	20.0	100
1,200–1,500	34.5	9.9	17.9	7.7	4.0	5.4	20.6	100
1,500–1,800	33.2	10.6	17.3	7.0	4.3	6.1	21.5	100
1,800–2,100	31.9	11.2	16.0	6.5	4.1	7.3	23.0	100
2,100–2,400	31.6	11.9	15.0	6.3	4.1	7.5	23.7	100
2,400–2,700	31.3	12.8	14.3	5.4	4.0	6.7	24.5	100
2,700–3,000	31.0	14.4	13.7	4.8	3.1	7.3	25.7	100
3,000 and over	31.4	14.5	12.5	4.6	3.5	6.6	26.9	100
All incomes	33.5	10.6	17.1	7.1	4.0	5.9	21.8	100

ticity of consumption, the greater the differences in expenditure on the item at different income levels. The greater the change in expenditure with changes in income, the less essential the particular item is to the family consumption. One of the methods of computing these coefficients is to fit a line by the method of least squares to dollar expenditures on the item and the total income. The resulting line $E = A + bI$ gives the requisite data regarding the expenditure.[1] An example for Columbus, Ohio, families' expenditure on food is shown in Fig. 11. When A is positive the commodity may be termed a *necessity;* when A is negative, a luxury. The percentage expenditure at any income level is readily computed and the elasticity of con-

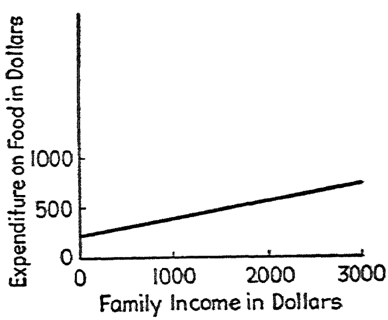

FIG. 11. Relationships between food expenditure and income of Columbus, Ohio, families, 1935 to 1936.

The height of the line is $210 at $0 income and it fixes $178 for each $1,000 increase in income. At $3,000 it thus represents food expenditures as $744.

[1] This method was developed by R. D. G. Allen and A. L. Bowley in their "Family Expenditures: A Study of Its Variations." In the fitted line E is the dollar expenditure on the item, A is the expenditure at zero income, b is the slope of the line or change in dollar expenditure for each dollar change in income, and I is the income in dollars.

sumption or income elasticity may be computed for any income level.[1]

An example of the results of this sort of analysis for families in the North Central States included in the Consumer Purchases Study of 1935–1936 is given in Table 27. Examining the A values we find food, housing, and household operation have high urgency in all

TABLE 27. LINEAR REGRESSION CONSTANTS FOR EXPENDITURES ON SELECTED ITEMS WITH CHANGES IN INCOME, BY SIZE OF COMMUNITY, IN THE NORTH CENTRAL STATES, 1935–1936*

	Columbus, Ohio		Small cities North Central		Villages North Central		Farm families Ohio and Pennsylvania	
	A Intercept	b Slope	A	b	A	b	A	b
Food	210	0.178	195	0.148	182	0.132	298	0.099
Housing	165	0.033	74	0.045	33	0.055	107	0.074
Household operation	86	0.046	46	0.061	47	0.056	80	0.024
Furniture and equipment	3	0.037	7	0.028	−54	0.067	16	0.014
Clothing	−38	0.107	−10	0.081	3	0.064	38	0.040
Auto	−56	0.113	−24	0.080	−106	0.163	22	0.050
Medical	22	0.030	12	0.042	13	0.024	27	0.011
Other	22	0.151	26	0.122	−24	0.105	53	0.032

* Adapted from the Consumer Purchases Study.

groups. The relative elasticities change considerably between groups. Note the decline in food and clothing as one progresses from the larger city to the farm, and by contrast the increase in housing.

4. Expenditures and Size of Family. The division of expenditures among the budget items is also influenced by the size of the family. As the family becomes larger, physical necessities require larger expenditures for food and for clothing, with a consequent reduction in other items of expenditure. The general trends for these expenditures are shown in Table 28 for families in Columbus, Ohio.

When food cost per unit is compared with the number of units in the family, a decided negative correlation is uniformly found. A similar situation exists with the clothing expenditure: while total expenditure increases, the amount spent per person decreases with the increase in the number in the family. The decline in the wife's

[1] The percentage expenditure is $p = (A/I) + b$.
The elasticity of consumption is $= bI/(A + bI)$.

TABLE 28. PROPORTION OF EXPENDITURE ON VARIOUS BUDGET GROUPS BY FAMILIES OF DIFFERENT COMPOSITION IN COLUMBUS, OHIO, 1935–1936, AT THE $1,500–1,749 INCOME LEVEL*

	Persons	Food	Housing	Household operation	Clothing	Automobile	Medical	Other	Total
Type I....	2.0	31.9	19.4	11.3	8.3	6.2	5.1	17.8	100.0
Type II...	3.0	32.0	17.2	10.3	9.2	10.6	3.9	16.8	100.0
Type III...	4.0	33.5	17.9	11.3	9.3	8.0	4.1	15.9	100.0
Type VI...	5.2	34.4	15.6	10.3	10.8	8.5	3.7	16.7	100.0

* *U.S. Bur. of Labor Statistics Bull.* 644, Table 2, Family Expenditure in Nine Cities of the East Central Region, 1935–1936. Family Type I is composed of husband and wife; Type II has one child under 16; Type III, two children under 16; Type VI, three or four children under 16.

clothing expenditure is especially marked. Expenditures for housing decrease, as do those for sundries and "miscellaneous."

The variations in the composition of families have made comparisons among them difficult, and some investigators have devised scales for measuring the size of family to facilitate comparison. Most of these scales relate to food and are usually based on the energy requirements of persons of different age and sex. Several important scales are shown in Table 29. The most famous of the general scales was

TABLE 29. SCALES FOR MEASURING SIZE OF FAMILY

Age	Engel's *quet* system (1883)	Energy requirements for food			Cost of food		Items other than food
		Atwater (1902)	Lusk (1918)	Bureau of Home Economics (1933)	Sydenstriker and King (1916)	Stiebeling and Ward liberal diet (1933)	Bowley housing (1912)
Under 1 year.......	100	30	50	40	28	47	...
5 years............	150	40	50	50	44	56	25
10 years...........	200	60	83	80	56	77	50
15 years...........	250	90	100	100	84	104	75
Moderately active adult man.......	350	100	100	100	100	100	100
Moderately active adult women.....	300	80	83	83	85	85	100

that originated by Engel in 1882, in which the unit was named a *quet* in honor of Quételet. The Atwater and the Lusk scales have been widely used in analyzing family data both in the United States and in other countries. The Bureau of Home Economics prepared several scales showing the quantities of the several nutrients which may well appear in nutritionally adequate diets for individuals in different age, sex, and activity groups. The tendency seems to be toward a diversity of scales rather than the development of a single scale. Much less work has been done and fewer scales developed for lines of expenditure other than food.

5. Food Expenditure and Income. Total expenditures on food customarily increase with higher incomes, but the proportion of the total expenditure taken by food is less in the high than in low incomes. The relationship is among the more stable of the income-consumption relationships and the elasticity of consumption is found in many recent studies to be about 0.67. Low-income groups in the United States spend as much as 40 per cent of their total expenditures on food; an ordinary proportion for the middle-class group would be around 25 per cent; whereas in high-income groups the proportion falls as low as 15 per cent. These changes, although of different magnitudes, are found generally throughout the world, and the proportion of the income spent on food furnishes a rough indication of the relative well-being of different groups.

A portion of the increase in food expenditure is due to the larger number of calories purchased at the higher income levels. Data are meager, but they indicate an elasticity of consumption of perhaps 0.20. The greater portion of the increase in the cost of food is due to a greater variety and the inclusion of more expensive food, in terms of calories, in the diet. The greatest increases in consumption are found in fruit, vegetables, dairy produce, and meat and eggs. The consumption of potatoes, bread, and sugar does not seem to differ greatly. These are changes that are desirable since they improve the quality of the diet. The following table shows estimates of the proportion of food values in terms of dollars at different income levels in the United States. Meat, poultry, fish, and eggs combined accounted for the greatest share of the money value of all foods in urban and farm diets. Vegetables and fruit are second and milk third in importance.

Low incomes and the resulting necessity of purchasing the so-called *energy foods*, which are low in calorie cost, rather than the *protective foods*, which are relatively high in calorie cost, lead usually to a progressive deterioration in the quality of the diet as the income declines,

unless unusual skill is exercised in the selection of foods. The incidence of nutritional diseases increases, in consequence, in the lower income classes in high-income countries such as the United States and is widespread in the poorer sections of the world.

There was a marked increase in the nutritive quality of the diet in the United States during the recent war period. "In 1936 three

TABLE 30. PERCENTAGE DISTRIBUTION OF MONEY VALUE AMONG VARIOUS CLASSES OF FOOD BY TYPE OF COMMUNITY AND SELECTED INCOME CLASS IN THE UNITED STATES, 1942*

Type of community and income level	All food	Milk†	Vegetables and fruit	Meat, poultry, and fish	Eggs	Grain products	Fats, oils	Sugar, sweets	Miscellaneous
Urban:									
$0–$499.	100	13	27	18	7	14	12	3	6
2,500–2,999. . . .	100	16	24	26	6	11	8	2	7
Rural nonfarm:									
0–499.	100	17	25	12	7	16	14	4	5
1,000–1,499. . . .	100	17	23	17	7	13	12	5	6
Rural farm:									
0–499.	100	22	24	15	6	11	13	5	4
1,000–1,499. . . .	100	23	24	18	6	9	11	5	4

* "Family Food Consumption in the United States," *USDA Misc. Pub.* 550, p. 38.
† Includes all milk products except butter.

fourths of the families in the United States had diets that did not meet the National Research Council recommendations for riboflavin and about half had diets that were low in calcium, thiamine and ascorbic acid. It is estimated that in the spring of 1942 the diets of more than one half of the families still did not meet the recommended allowances for riboflavin and that the proportion of the diets low in calcium had been reduced to less than a third; the proportion low in thiamine to a fourth; and the proportion low in ascorbic acid, in which there was the greatest improvement, to less than a tenth. There was also a great reduction in the estimated proportion of the families that had diets low in vitamin A value, iron and protein—from about one fourth in the earlier period to about one tenth in the later period."[1]

The following data from a Bureau of Home Economics study of the reports from the Consumer Purchases Study indicate their rating of the diets reported in the villages and cities in 1936–1937 in the North

[1] "Family Food Consumption in the United States," *USDA Misc. Pub.* 550, pp. 34–35.

and West. The good diet is one that meets the average minimum requirements with a wide margin of safety in all respects. A fair diet is one that meets average minimum requirements in all respects with an uncertain margin of safety. A poor diet is one that fails to meet average minimum requirements in one or more respects. Corrections for price changes would have to be made in the data in Table 31, to make them applicable to postwar conditions.

TABLE 31. QUALITY OF DIETS AT DIFFERENT LEVELS OF FOOD EXPENDITURE IN NORTH AND WEST CITY AND VILLAGE FAMILIES, 1936–1937*

Weekly food expenditure per food-expenditure unit	Number of households	Proportion of households with diets graded:		
		Good	Fair	Poor
\$1.38–\$2.07	305	0	27	73
2.08– 2.76	530	6	61	33
2.77– 3.45	779	24	64	12
3.46– 4.14	151	52	44	4
4.15– 4.83	229	69	28	3

* "Family Food Consumption and Dietary Levels," *USDA Misc. Pub.* 452, p. 57.

6. Clothing Expenditure and Income. The expenditure on clothing is flexible and subject to considerable variation among families. The most usual proportion of the total expenditure would be between 10 and 15 per cent. Most surveys of the lower income groups show elasticities of consumption slightly above one, whereas the coefficients tend to be below one for the higher income groups. Among the lower incomes the husband's expenditure on clothing exceeds that of the wife, but the wife's expenditure rises more rapidly than that of the husband and with moderate incomes equals or exceeds his. On the high-income levels, the wife's expenditure is generally greater than that of the husband. The daughter's expenditure on clothes usually exceeds that of the son at all ages and on all income levels. The expenditures of grown sons equal or exceed those of the father and the expenditures of grown daughters exceed those of the mother, and the trends in both cases increase with income. The expenditures for the younger children are much less than for the adults and maintain a fairly constant relation to the expenditures on the father's clothing. Table 32 gives some comparisons.

TABLE 32. CLOTHING EXPENDITURES IN FAMILIES WITH INCOME OF $1,500–1,999 IN 1935–1936 BY AGE, SEX, AND SIZE OF COMMUNITY*

	Husband or wife	16–19 years	12–15 years	6–11 years	2–5 years
New York and Chicago:					
Male	$55.47	$37.77	$29.20	$28.56	$16.86
Female	61.86	57.23	32.79	24.49	18.68
North and West, small cities:					
Male	66.91	59.27	37.95	33.78	21.61
Female	75.86	76.39	51.13	32.07	25.98
North and West, villages:					
Male	53.74	50.78	34.29	27.60	23.83
Female	60.50	81.35	43.03	30.76	24.49

* *U.S. Bur. Labor Statistics Bull.* 648, "Family Expenditures in Selected Cities, 1935–1936," vol. III, "Clothing and Personal Care," pp. 19, 22; "Family Expenditures for Clothing," *USDA Misc. Pub.* 422, pp. 86, 184.

An increase in income raises clothing expenditure by increasing the number of purchased articles already being bought and the price paid per article, and in some cases leads to the purchase of entirely new articles hitherto lacking in the wardrobe. Indexes based on the important clothing items are given in Table 33, showing the change in price and quantity of clothing for certain family members as the income increases. It appears that increases in quantity were greater than those occasioned by changes in price in the expansion of the clothing budget for all of the included groups.

TABLE 33. INDEXES OF CLOTHING EXPENDITURES, QUANTITY PURCHASED, AND PRICE AT DIFFERENT INCOME LEVELS, NORTH CENTRAL AND WESTERN SMALL CITIES, 1935–1936*
($1,500–1,999 income level = 100)

	Expenditures				Quantity				Price			
	Husband	Wife	Female 16–19	Male 16–19	Husband	Wife	Female 16–19	Male 16–19	Husband	Wife	Female 16–19	Male 16–19
Under $500	34	37	53	33	41	45	67	45	83	83	79	74
$500–$999	37	43	53	52	55	61	67	60	67	71	79	86
1,000–1,499	62	68	84	70	78	79	98	80	80	86	86	87
1,500–1,999	100	100	100	100	100	100	100	100	100	100	100	100
2,000–2,999	127	131	139	141	122	111	126	128	104	118	110	110
3,000–4,999	174	181	192	155	146	127	140	124	119	142	137	125
5,000 and over	262	288	282	195	197	177	157	154	133	163	180	127

* Computed from data in "Family Expenditures for Clothing," *USDA Misc. Pub.* 422.

7. Housing and Income. The expense of housing a family is second only to food in amount of expenditure. Families in large cities at the lower income levels are forced to apportion as much as one-third of their expenditures for living quarters, including expenses for fuel, light, and refrigeration. As total family expenditure rises, expenditures on housing increase, although at a somewhat lower rate, and the proportion expended on housing declines. The lowest percentage of the total is found in the highest income brackets where one-fifth or less of the total expenditures may be on housing.

TABLE 34. VALUE AND RENTAL OF HOMES IN THE UNITED STATES, 1940*

Value of owned homes	Percentage of homes	Monthly rental	Percentage of homes
Under $1,000......	23.6	Under $10.......	15.9
$1,000–$1,999. ...	19.6	$10–$19.........	24.3
2,000– 2,999. ...	16.3	20– 29.........	22.7
3,000– 3,999.....	13.3	30– 39.........	16.1
4,000– 4,999.....	8.6	40– 49....... .	9.2
5,000 and over....	18.6	50 and over.....	11.8

* U.S. Census, 1940: "Housing," vol. II, "General Characteristics," Part 1, U.S. Summary.

The 1940 census gives the median monthly rental for the United States as $18.22 and the median value of owned homes as $2,377. Rentals and house values are distinctly lower in the South than in the North, and in smaller towns and cities than in the larger metropolitan areas. Table 34 indicates that about 60 per cent of the owned homes in the United States were valued at less than $3,000 in 1940 and over 60 per cent of the rented homes had rentals of less than $30

TABLE 35. QUALITY OF HOUSING IN THE UNITED STATES IN 1940, BY REGION*

	Proportion of dwellings with—				
	More than 1 person per room	Central heating	Electricity	Flush toilets	Running water
United States......	20.3	42.0	79.2	64.7	69.9
North............	14.4	60.2	89.2	75.5	79.1
South.............	32.8	11.4	54.9	40.4	46.0
West..............	17.7	27.1	89.9	75.8	82.7

* U.S. Census, 1940: "Housing," vol. II, "General Characteristics."

a month. The quality of housing varies greatly between sections of the country and between urban and rural communities. Table 35 shows some of the characteristics which may be taken as indexes.

It is a general rule that the value of a person's house should not exceed two to two and a half times his annual income. Such a ratio would be equivalent to an expenditure of 20 to 25 per cent on housing. Examination of Table 26 will show city families to have reached such a level at incomes of around $1,500 and above when fuel, etc., is included. Below $1,500 somewhat more than 25 per cent is likely to be allocated for housing and household operation.

8. The American Level of Consumption. There are, of course, a variety of levels of consumption among families in the United States. It is, in consequence, impossible to pick out any level which is typical. It is, however, worth while to describe briefly the characteristics of the families in the special study made from 1934 to 1936 of city wage earners and low-salaried clerical workers by the Bureau of Labor Statistics. This is the group whose purchases are typified in the Bureau of Labor Statistic Consumer Price Index described earlier. It is a group thought representative of a large number of our city families. Included in the study were 14,469 families in 42 cities. The families averaged 3.79 persons in size and had an average income of $1,512.

The largest expenditure was for food, which amounted to $508. This was 33.5 per cent of the total expenditures. It provided about 55 cents a meal for the family or about 14 cents a meal per person. At this level there was sufficient expenditure to buy the "minimum-cost adequate diet" of the Bureau of Home Economics. When all the families in the study were considered, however, 25 per cent were spending less on food than the amount required to buy this diet. Housing was the second largest expenditure, averaging 17.1 per cent for rent and 7.1 per cent for fuel, light, and refrigeration, or 24.2 per cent for both. This would amount to $34 a month. The homes where people had an income above $500 a year typically had a bathroom with inside flush toilet and running hot water. They had electric lights and gas or electricity for cooking. Two-thirds had central heat and 30 per cent had telephones.

Clothing was the third most important line of expenditure and on the average took 10.6 per cent of the expenditures. The men were buying 3½ shirts a year, a $24 suit every other year, and a $21 overcoat every fifth year. The women were averaging 3 dresses a year of which 1½ were cotton house dresses, 12 pairs of stockings at an

average price of 72 cents, and 2¼ pairs of shoes, totaling $7.85. The men bought 1½ pairs of shoes and 10 pairs of hose during the year. These listed items made up about 70 per cent of the clothing expenditures.

Forty-four per cent of the families had cars, which were nearly all secondhand. The cars had cost about $300 in addition to the trade-in value of an older car. The annual cost of operation of the car averaged $123. At the lower income levels the cars were third- or fourth-hand and at the higher levels there was an increasing proportion of new cars. Autos took 5.8 per cent of the total expenditure on the average for the group, and other transportation 2.5 per cent.

Recreation took 5.4 per cent of the expenditure and amounted to $82 for the year on the average. Tobacco accounted for one-third of these expenditures; cigarettes were purchased by only a little over half of the families on the low income level and by three-fourths on the high income levels. About 50 cents per week went for this expenditure on the low and 90 cents a week on the high income levels. Reading the daily paper and movie attendance were the items most commonly reported. Movies cost about $15 per family per year on the average. About 45 per cent of the families purchased magazines. On the other hand, only one family out of 20 purchased a book during the course of the year aside from schoolbooks for the student members of the family. Access to public and rental libraries may explain part of this.

Medical care cost $59 a year on the average, with most to the general practitioner and then the dentist. Personal care amounted to $30 with half going to the barbershop and beauty parlor and the other half for soap, dentifrices, and such supplies. Formal education accounted for less than ½ of 1 per cent of the expenditures.

Questions

1. How would you expect expenditures of a family having at present an income of $2,400 a year to compare with a similar family with an income of $2,400 in 1913?
2. Which budget groups show the greatest rise and fall?
3. What classifications of expenditures other than the usual budget classifications might be significant in showing the characteristics of family life?
4. In what lines of expenditure are differences in income most apparent?
5. How significant do you think the computed elasticities of consumption would be as indicators of probable changes in demand following changes in income?
6. What relations, if any, would there be between the elasticity of consumption and elasticity of demand for a commodity?

7. Based on a study of expenditure patterns of two different classes of individuals or groups found in this text or elsewhere, describe in as much detail as possible the differences in their manner of living.

8. Suppose a family had an income of $400 per month and that exactly this amount was expended for food, shelter, clothing, education, medical service, etc. Could this family be said to be living within its income? How about contingencies? Deferrals?

9. One economist recently said: "Enforcement of the Heller standards for every worker would be impossible. It could be made possible only by an average rise in the output of consumer goods of over 60% per worker per year." (See Heller Committee Budget Studies, University of California.) Assuming this statement is correct, what are its economic implications?

10. Considering the fact that a substantial proportion of consumer expenditures is for housing, evaluate the possibilities of mass-production methods in home building as a device for effecting consumer savings.

CHAPTER XIII

VARIATIONS IN CONSUMPTION

The demands for particular products by consumers bear certain relations to one another. Certain groups of products may be said to have *competing demands; i.e.*, the consumption of one product means that some other products will not be consumed. Commodities that are substitutes for one another fall into this class, the most important example of commodities of this kind being food.[1] The national per capita consumption of food, when considered on a calorie, or thermodynamic, basis, remains quite constant. Calorie consumption, of course, varies with different nations and among classes within the nation. These differences are due to certain climatic differences and to differences in the character of the population. People living in cold climates, for example, require more calories than those living in warm climates. The nature of the occupations of people also affects their calorie consumption. Those doing vigorous outdoor work consume more calories than those engaged in sedentary occupations. Habits in housing and clothing, as well as waste in food preparation, will also affect consumption. People's size and their distribution among the various age groups will have some effect. These factors appear to be sufficient to explain international and sectional differences in calorie consumption. It was estimated before the First World War, for example, that the daily per capita consumption of Italy was around 2,560 calories, the United Kingdom 2,860 calories, and the United States 3,650 calories.

Among the normally prosperous nations, such as the United States, the total consumption of foodstuffs measured in calories remains fairly constant, regardless of variations in the national income. Changes take place in the selection of foods that go to make up this calorie intake, however. In prosperous times some of the undernourished may be brought up to normal, but for the majority there will be no increase in calorie consumption. The shift in such times is rather to more desirable foodstuffs. More meat is consumed, and

[1] See A. E. TAYLOR, "Consumption, Merchandising, and Advertising of Foods," *Harvard Business Rev.*, April, 1924.

less cereals and potatoes. Similarly, in less prosperous times there is a change in kinds of foodstuffs composing the diet, but little change in its calorie volume. When times are hard in the North, the use of flour increases and the consumption of meat declines. In the South, the use of corn increases and that of wheat declines. There is everywhere a substitution of cheaper calories for higher priced ones.

This has an important bearing on the introduction of a new foodstuff into the diet or on the enlarged consumption of one already there, since it means that this foodstuff does not constitute a new addition to the diet but acts as a substitute for some food already there. Thus the addition of a new food means an approximately equal calorie-value reduction in the consumption of some other food or foods. Advertising of their product by a group of producers, which results in an increase in the consumption of that product, means necessarily a decrease in the consumption of something else.

The demand for certain products may be said to be *complementary; i.e.*, in some cases when one product is consumed a great deal more satisfaction can be obtained from it if another commodity is consumed with it, and a similar relationship exists with the other commodity. Bread and butter, a phonograph and its records, and a dress suit with the proper shirt and tie are all examples of this rule. A change in the demand for one is likely, because of this relationship, to be accompanied by a similar change in the demand for the other. The demand for other products may be said to be *individual; i.e.*, a demand for such goods has little relation to the consumption of other goods for the satisfaction derived from them.

Variations in consumption may be considered in four ways: (1) as among individuals or groups, (2) as among income classes, (3) as among periods of time, and (4) as among places. Each of these types of variation involves special economic problems; consequently each will be considered separately.

1. Variations in Consumption as among Individuals or Groups. *Standards and Scales of Living.* A comparison of the consumption of individuals reveals a striking similarity in the consumption habits and goods utilized by those composing a particular social or industrial group. People of a particular class located in the same geographic area consume much the same sort of goods as their neighbors. Our clothing, food, and even the houses in which we live are fundamentally the same as those of our associates, although the individual items making up the list of goods consumed may differ materially.[1] This

[1] That is, one may eat steaks, another chuck roasts; on the other hand, one drives a new light car, another an older large car, etc.

basic similarity is particularly true of the parts of consumption that come under the observation of others. Among classes, however, the situation is quite different. The commodities that bank clerks as a class consume are in part similar, yet are quite different from those of garage mechanics; some aspects of this difference can be explained readily while some remain obscure. In the same manner it is possible to distinguish characteristics of classes all the way through society. Broad comparisons may be made on the basis of these habits and some important generalizations may be drawn from them. This is true for nations as well as for groups within a nation, although the former phase has less meaning, perhaps, than the latter.

Table 36, designed for conceptual purposes, distinguishes several notions involving standards and scales of consumption and living. Thus *consumption* and *living* are distinguished one from the other—the former includes only marketable goods and services, while the

TABLE 36. CONCEPTS OF PLANES, LEVELS, AND STANDARDS OF CONSUMPTION AND LIVING*

	Consumption	Living
1.	*Plane of Consumption* is the list of marketable economic goods and services actually consumed by an individual or group of individuals. One's plane of consumption might include fine food, a sumptuous home, a large motorcar, etc. One might even properly speak of a nation's plane of consumption.	*Plane of Living* is the list of goods, services, and conditions actually consumed or experienced. This includes not only marketable goods and services and the use of public facilities, but the location of one's residence and freedom of choice as to occupation and working conditions, to name only a few.
2.	*Level of Consumption* is the aggregate or composite of marketable goods and services making up the plane of consumption, theoretically expressed in one number (calories, pounds, square feet, prices, or whatnot). Actually price is the only common denominator applying to all goods and services, since calories, pounds, and square feet are special-purpose designations. Technically, the level of consumption may properly be referred to as "high" or "low."	*Level of Living* is the aggregate or composite of goods, services, or conditions which constitute the plane of living, theoretically expressed in one number. Actually health, food, democracy, and park facilities, for example, cannot be aggregated even on a price basis, although the level of living may be referred to generally as "high" or "low," perhaps.

*Adapted from J. S. DAVIS, Consumption Level; Consumption Standard; Plane of Living; Standard of Living, *J. Marketing*, vol. VI, pp. 164–166, October, 1942; and A. KOZLIK, Concepts of Plane, Standard, Level, and Satisfaction of Consumption and of Living, *J. Marketing*, vol. IX pp. 55–57, July, 1944.

TABLE 36. CONCEPTS OF PLANES, LEVELS, AND STANDARDS OF CONSUMPTION AND LIVING—*Continued*

	Consumption	Living
3.	*Standard of Consumption* is the list of marketable goods and services which an individual or group earnestly strives to attain, to maintain if once attained, and to regain if lost. The list making up the standard of consumption may be much more elaborate than that composing the plane of consumption.	*Standard of Living* is the list of goods, services, and conditions which an individual or group earnestly strives to attain, to maintain if once attained, and to regain if lost. The list of goods, services, and conditions composing the standard of living may be very much more elaborate than that composing the plane of living.
4.	*Standard Level of Consumption* is the aggregate of the list of marketable goods and services included in the standard of consumption, theoretically expressed in one number. Thus, technically one should not speak of a high *standard* of consumption, but of a high *standard level* of consumption.	*Standard Level of Living* is the aggregate list of goods, services, and conditions included in the standard of living and theoretically expressed in one number. Like its counterpart in consumption, from the standpoint of technical accuracy one should refer to a high or low standard level, rather than a high or low standard of living.
5.	*Satisfaction of Consumption* is the utility derived from the consumption of the marketable goods and services making up the plane of consumption. This is a subjective concept and is not actually measurable.	*Satisfaction of Living* is the utility derived from the list of goods, services, and conditions consumed or experienced rather than the list itself. This concept is subjective and nonmeasurable.

latter includes nonmarketable goods, services, and conditions such as free public facilities and even working conditions, and, indeed, possibly freedom of choice. Moreover, *standards* are distinguished from *planes* and *levels*—the former are goals toward which consumers strive, while the latter include only conditions actually achieved. Futhermore, the designations *plane* and *level* are distinguished—the former has to do with the lists of goods, services, or conditions enjoyed by the individual or group while the latter, theoretically at least, is the composite of things making up the plane expressed as a single figure (such, for example, as dollar expenditures) for items entering into a budget.[1] Finally, the satisfactions derived from the possession and

[1] Unfortunately, expenditure patterns may offer little aid in determining exact living scales. A certain scale of living as indicated by one's present expenditures may reveal very little in the way of an intellectual interest, when actually the

use of goods and services are distinguished from the goods and services themselves even though such satisfactions are largely unmeasurable.

For discussion purposes in this book, consumption and living will be carefully distinguished in the manner indicated above. Also, standards (connoting some degree of attainment toward which one aspires) will be distinguished from levels and planes (which have to do with actual accomplishment). However, instead of attempting to distinguish levels and planes, as in the table, both of these concepts will be utilized interchangeably with the term *scale* which usually will replace both, depending on the context to indicate whether one is referring to actual commodities and conditions or to a single number designation purporting to represent them. No attempt is made in this section to deal with the subjective concept, satisfactions.

To summarize the discussion thus far, the actual commodities and services that a person or group consumes are termed the *scale of consumption* of the person or group; the *scale of living*, a broader concept, includes conditions as well as goods and services. The *standard of consumption* is to be contrasted with the *scale of consumption*, in that the former is more a goal toward which one strives; the *standard of living*—a broader concept—is a *desired manner* of living which includes not only ordinary consumption items but noncommercial conditions as well. The standard, then, is the level that people feel belongs to them and that appears to be reasonably within their efforts to attain; it is, moreover, something which may or may not be realized. The scale is the result of choices which are conditioned largely by standards. It should be noted that the scales of consumption and of living are typically, perhaps, partial fulfillments of a standard. The standard of living is not the best imaginable way of living, but the way people feel it incumbent upon them to realize, and without attainment of which they will be oppressed by a feeling of dissatisfaction. The standard of living is, to some extent, a social product, and from the viewpoint of the individual appears often as something that is imposed upon him from the outside.

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individual is a voracious reader of *library* books, an avid auditor of *radio* concerts, a frequent visitor to *free* art galleries. On the other hand, an individual with a newly acquired income whose interests are exceedingly circumscribed may, because of the pressure from luxury salesmen, produce an expenditure pattern indicating an imputation of great value to the so-called "finer things," when such is not the case at all. Expenditure patterns in themselves, then, reveal little accurate information as to the exact nature of one's scale of living.

There are several additional important aspects of standards and scales of consumption and living. These follow:

1. One cannot very well speak of a *high* or *low* scale of consumption or living as between groups in roughly the same category.[1] That is, it is improper to refer to one who has a small house and sets a modest table but purchases the best seats for concerts and operas as having a higher or a lower scale than one who has a larger house and sets a fine table but listens to his operas and concerts over the radio. On the other hand, a person who is inadequately fed and lives in a hovel and has no radio may be said to have a lower scale than either of the two aforementioned individuals whose scales cannot be compared in this manner. This suggests the existence of a number of consumption levels in our society.[2]

2. There is little question but that one's general environment has an important effect on one's standard, hence on one's scale of consumption also. People in the United States, generally speaking, normally have confidence that reasonable standards are attainable, even by the so-called "common man." This note of optimism probably is of great importance as an influencing factor on the standard of living of many. But one should distinguish perhaps between the general environment of the community or even of the entire nation and the immediate environment of the family. Even the latter may not explain too much, however, for who knows whether a boy reared in a poor East Side family will have a "low" standard of living (because of the poor conditions to which he has become

[1] Some more or less arbitrary basis of measurement must be provided if one is properly to utilize the designations *high* or *low* to describe consumption and living standards. Thus a standard may be high which includes a *large amount* or *variety* of goods and services; or, on the other hand, this designation might be utilized to indicate a desire for a smaller amount of *high-quality* commodities. It might, however, refer merely to the amount expended, a very unsatisfactory criterion. The designation may not refer to any of these, however, but may imply the adequate meeting of some much more definite test. Thus in foods, for example, a certain number of calories is necessary to continued health, and in housing a certain minimum amount of space is thought to be required for health, decency, and self-respect; the individual having more than adequate food or housing would thus be distinguished from the one having less.

[2] Prof. P. H. Nystrom ("Economic Principles of Consumption," p. 278) offers 10 such levels as follows: (1) public and semipublic charges, (2) the work-shy tramps, hobos, and incompetents, (3) poverty, (4) bare subsistence, (5) minimum for health and efficiency, (6) minimum comfort, (7) comfort, (8) moderately well-to-do, (9) well-to-do, and (10) liberal level of living.

accustomed) or will aspire toward a "high" standard (because he hates his environment and is ambitious to rise above it)?

3. The reason for the inclusion of the goods which we find in our present scales and standards is an interesting speculation. Many are supposed to have been selected as the result of a trial-and-error discovery made early by human beings. It is thought that these particular goods possess survival value. Those who experimented with unfamiliar foods or other strange things often met with death, and the goods that met the test became incorporated in the standard. Primitive people are extremely conservative and cling with great tenacity to their habits. Survival value has ceased, however, to have much importance as a basis of inclusion of new things in our present standard. Life is now too complex to allow us to work things out in this manner.

There are some goods that are included as symbols of status and accomplishment and to meet the desire for distinction and recognition. Society has devised few ways of indicating economic power other than "conspicuous leisure and conspicuous consumption."[1] Goods of this type (expensive fur coats, say) are not included in consumption for "utilitarian" purposes only, but as symbols of a class as well. The higher the economic class, the larger these items bulk. Only the few groups where other insignia of rank are available, such as the academic professions and the military, escape this sort of display and even here it is not unknown. The lower ranks ape the higher, and the display in some of its forms reaches the very lowest ranks.

Another factor of great importance, perhaps, is the inventiveness of a people, which leads toward the offering of varied and attractive goods and services in the market place for the approval of consumers. The idea here is that goods and services are devised (the automobile, the radio, electrical refrigerators, or whatnot) and the very fact that they exist and perform a useful function causes people to want them. This suggests that invention often is the mother of necessity rather than the converse.

Much of this phase of the subject of consumption is imponderable, however; the combinations arising out of the variations in the intensity of various instincts and drives—*e.g.*, hunger, sex desires, gregariousness—combined with such environment factors as education, family living conditions, and everyday contacts probably are infinite. The result of any one influence alone is difficult enough to predict. To know why a person reacts the way he does, one would

[1] See T. Veblen, "Theory of the Leisure Class," Chaps. III and IV.

have to know that person's entire life, his parents' lives, and the life of everyone he had ever met. One would have to know every word ever said to him, every word he had ever said, what he had seen, read, thought about, done—even what kind of food he had eaten.[1]

4. It should be noted that one's scale may be below one's standard (as in the case of a young medical doctor just getting started in his profession), above it (as in the case of the Indians on whose property oil was discovered), or the two may be approximately the same (as in the case of many older people who have arrived at the goal they have set).

There are, as was suggested earlier, important relationships between standards and scales of consumption and living. If the scale of consumption is below the standard of consumption, for example, there is a feeling of privation and dissatisfaction; if above, a feeling of security and plenty. The whole problem of the restlessness of industrial groups is inseparably bound up with this relation between standards and scales of consumption and living. The standards of consumption of many of the very poor are pitiably low, as is evidenced by their contentment with their scale of consumption. "If only the poor were discontented," say many social workers.

Over a period of time, there is a constant tendency for the standard and the scale of consumption of a particular group to become adjusted. Thus, if in a certain group the income decreases so that the scale of consumption is considerably below the standard, those in the group are likely to marry later and have smaller families, thus attempting to preserve as much of the scale as possible. Moreover, we are less likely to find the children remaining in the same group, with a result that subsequently, with relatively smaller numbers, the members of the group earn more than in the previous generation, with a consequent "raising" of the scale of consumption. Increases in income are likely to result in "higher" scales of consumption and in "higher" standards as well. The effect of the increase in income depends in part upon the character of the individuals and in part upon the manner and suddenness of the increase. When the increase in the scale of consumption results in higher standards, the former is likely to be maintained, but if the standards remain the same, the group tends in the next generation to expand in size enough to lower the scale of consumption to the old level. Sudden and large increases of income are seldom of much fundamental benefit to the recipient.

[1] To paraphrase the philosophizing of Dr. Ditten in Ethel Vance's "Escape," p. 253.

Much of the increase probably will be squandered in ways that yield little lasting satisfaction, and often in ways that are detrimental, as in the case of some newly "discovered" movie stars. This is in part due to the fact that it takes both experience and thought to consume intelligently. If, on the contrary, the increase has been gradual or, better yet, if it is unrecognized, coming in the form of a gradual decrease in prices, the larger income will probably be well used and result in a higher standard, as well as a higher level, of consumption.

5. As should be clear from the foregoing, scales and standards of consumption and living are not fixed. They change, however, only slowly in their main outlines. They "rise," or include more commodities or conditions, somewhat more easily than they decline. To decrease one's scale of consumption, at least those portions which are visible to others, is looked upon as a public confession of failure and a thing seriously to be avoided. In consequence, restrictions in consumption following a decrease in income frequently lead to a continuation of the consumption of articles visible to others, even though these may not be essential, and to the discarding of articles necessary for efficiency, but which are not visible. Further evidence of the importance of society over the consumption of the individual is found in the arrangement of the consumption of many persons. The things that society can see and make judgments on are often stressed at the expense of the less visible items that go to maintain bodily health and vigor. The heavy expenditures of poor families for elaborate funerals at the expense of the proper nourishment of the family, and the shopgirl's choice of nylon stockings at the expense of warm undergarments are examples of this tendency.

6. Standards and scales of consumption and living have many very practical implications. For one thing, the standard of living of a community has an important bearing on the size of the population of that community. In fact, one of the pioneer thinkers in the field defines a living standard as " . . . The scale . . . which the average individual of any group considers preferable to marriage, or which he must be sure of maintaining before he will marry and undertake the support of a family."[1]

The standards of living have a great bearing on consumption and may also have a definite bearing on the amount and types of goods which a group (if able!) may be *willing* to purchase. It is conceivable, for example, that a group looking for increased wordly pleasure as an

[1] Thomas Nixon Carver, The Standard of Living, Encyclopaedia Britannica, vol. 21, p. 308.

end rather than security, say, may be quite willing to continue to purchase time- and energy-saving goods while eschewing insurance and annuity policies. This suggests the important fact that the standard of living, as well as income, has a part in determining the volume of savings. One cannot read studies of crime and delinquency without concluding that standards of living have a great influence on the number of moral derelicts found in modern society. These concepts have a sociological aspect, then. It is interesting to contemplate the part played by living standards as a cause of war.

Fashions. The phenomenon of the downward diffusion of fashions illustrates the power of this source of modification of consumption patterns as among individuals or groups. It is possible for a comparatively small group of acknowledged leaders with economic power and professional position to exercise a dominant influence over a considerable portion of the consumption of the great majority. Fashion as an influence on consumption will probably become more pronounced as society becomes more completely organized on a pecuniary basis, with economic position becoming more completely established as a factor distinguishing the classes, and will also become more pronounced as incomes, in general, grow. This element of our consumption may or may not be detrimental; it depends upon which class society sets out to follow and upon the inherent worth of the insignia of that class. Much is to be accomplished in awakening the rich to the responsibilities of their consumption, since in general the lower income classes tend to conform to modes established by the wealthy.

Fashions are semirecurring ways of doing things[1] and are to be distinguished from progress, which, involving change, does not recur.

[1] Prof. Paul H. Nystrom in his "Economics of Fashion" distinguishes style and fashion. Style is a mode or method of expression in some art—painting, writing, dressmaking, golf playing, what not. Fashion, on the other hand, is the prevailing style at any one moment of time. Thus the clothes of the nineties are of a certain *style*, but they are not in *fashion*. Fashion can be explained if one looks for the physical and psychological motives underlying the phenomenon. On the physical side, the seasons offer points at which changes actually are necessary. Hence, in clothing, instead of purchasing items identical in style, there is an opportunity to select something different. On the psychological side, there is a combination of factors that make for a desire for changes. Among these are the desire for display, the experiencing of fatigue or boredom, the desire for new sensations, a real desire for improvement. Add to these the fact that the wealthy both want and are able to rebel against convention and that the impecunious, curiously enough, have a fear of being unconventional, and you have the psychological basis of fashion.

Fashions seem to start among those who, because of their wealth or talents, distinguish themselves from others. They are acts of differentiation, modes of setting oneself apart. The fashion then proceeds in a regular cycle.[1] Those who possess considerable incomes imitate the leaders. And the imitation proceeds successively down to the lower classes. When, however, the fashion is generally accepted, it sows the seeds of its own obscurity, for it now becomes necessary for the leaders to differentiate themselves again. Hence the paradox that the success of the fashion is to be judged by its subsequent popularity but that that very popularity leads to its own destruction. Fashion is accelerated by widely diffused income, by population mobility, and by agencies of mass impression. The fashion cycle is slowed down somewhat by the conservative group who cling to the old styles as long as possible and who change to the new in the most moderate manner possible rather than adopting the extreme of the style.

One of the most interesting problems in the whole fashion picture is that having to do with the origination, adaptation, and acceptance of styles. Styles, it must be recalled, are not plucked out of thin air. The more one studies the subject, the more convinced one becomes that "there is nothing new under the sun." Many styles are inspired by works of art (as, fabric colors by old Italian paintings); others by current events (the square-shoulder effect on women's coats from the military uniforms of the Second World War);[2] still others by related items (women's slacks by beach pajamas). Many other styles are merely reversions to the modes of earlier years (turtle-neck sweaters from the fashion current decades ago). Some, to be sure, are purely utilitarian adaptations (capes designed for the purpose of preserving the "fluff" in the huge leg-of-mutton shirtwaist sleeves).

[1] The fashion cycle can be measured objectively by means of fashion counts. When the data are plotted, the resulting figure is a graphic representation of the acceptance, rise, culmination, and decline of a style. Fashion cycles can be broken by catastrophe, war, or weather changes at the end of a season. However, fashions starting late in the summer and becoming quiescent by virtue of the season's end are likely to continue the following year. Moreover, the *use* and *purchase* cycles are not precisely contemporary, the former lagging behind the latter.

[2] The shoulder bag popular in the early and middle 1940's seems to present an example also, but according to one student of fashion it was offered to the public before being adopted by the military for wear by women members of the armed forces. It is likely, however, that public acceptance of the item was accentuated by the military adoption combined with the kind of thought and activities which developed out of war conditions.

A couturier upon designing a garment, of course, may or may not achieve success, since public acceptance determines the fashion.[1] In other words, every style does not become a fashion. Success of a style depends on current thinking and manner of living, the way the particular style fits in with prevailing modes, generally,[2] and the stage in the fashion cycle reached by the item whose place the new style would take, among others. Just how much of the success of a fashion is due to the motif is imponderable. Certainly public interest in and sympathy toward Latin America makes acceptance of styles originating therefrom more likely at least. The converse is apt to be true, too. If a style does become popular and is adaptable in other lines of merchandise, such will be the result. Witness the adaptation of the tricolor motif, inspired by the French Colonial Exposition, in practically all wearing apparel and accessory lines in the early 1930's.

With respect to the geographical origin of styles there is much argument. According to some experts Hollywood is now the style center, according to others New York is predominant, and according to still others Europe continues to "set the styles." The data in Table 37 are the result of a more or less successful attempt to find the answer. The items were so selected that the name of each was sufficient to suggest its exact nature. The material was gathered from periodicals and from communications and interviews with various fashion commentators. The fact that the dates could be determined only approximately characterizes quite clearly the will-o'-the-wisp nature of the phenomenon.

Several interpretive comments may be made regarding the material contained in the table. In the first place, it will be noted that in every instance the style originated or was first adapted in Europe: men's styles are predominantly British in origin and women's predominantly French. If we may accept this sample as adequate, the indications are that those who hold that most of our styles originate at home are in error. In the second place, though many items *originate* in Europe *adaptation* takes place in the United States and the "end item" may be quite different from the original. Compare, for example, the original "New Look" garment which emanated from

[1] According to Mainbocher, famous designer (*Los Angeles Times*, Dec. 1, 1947), "In this day and age couturiers cannot impose designs on their feminine clientele. Instead they must propose fashions, then sit back and wait for milady's acceptance or rejection."

[2] For example, the postwar success of the "Gibson Girl" style might have been predicted once the longer skirt, narrower shoulders, and wider hip silhouette obtained acceptance.

TABLE 37. ORIGIN OF A SELECTED GROUP OF FASHION ITEMS, 1935

Item	Place and approximate time of origination	Comments
Men's:		
Midnight-blue tuxedo	England, middle 1920's	Received impetus about 1931 after acceptance by the then Prince of Wales; especially popular in Hollywood owing to photographic qualities
Mess jacket	British tropical provinces and Riviera, late 1920's	Worn for years by British army officers in tropics; popularity has not been lasting owing to too rapid acceptance and similarity to waiters' costume
Tyrolean hat	Austrian Tyrol adaptation, England; date not known	First introduced into England by English hunters returning from shooting season abroad
Deep-tone shirt	England, early 1930's	Inspired by popular shades in polo shorts; first introduced by custom shirtmakers; popular acceptance followed rapidly
Brown buck shoes	England during First World War	Inspired by reversed-calf trench boot; acceptance rapid, adopted by English sportsmen. Success probably due to early adoption by the then Prince of Wales, subsequent adoption by America's most popular dancing cinema star, and their unusual practicability
Jockey shorts	French Riviera, late 1920's	Adaptation of a bathing trunk introduced originally on the Riviera
Women's:		
Sport-back suit	France, early 1930's	Adapted from men's sport suits, acceptance probably due to trend toward mannishness in women's out-of-door attire
Slacks	Deauville, early 1930's	An adaptation of the beach pajama introduced some years ago at Deauville, acceptance probably due to mannish trend, comfort, and greater out-of-door activity

TABLE 37. ORIGIN OF A SELECTED GROUP OF FASHION ITEMS, 1935—*Continued*

Item	Place and approximate time of origination	Comments
Flat-heeled evening shoes.......	France, about 1933	Probably a manifestation of the sports influence; *Vogue*, Dec. 15, 1933, refers to them as the very latest in shoes
Halo hats........	Paris, about 1934	Inspired by one of Mantegna's paintings, Renaissance Art Exhibit; gained almost immediate popularity in the United States
Tennis shorts.....	Deauville, late 1920's	When first introduced they were knee length; at first used only for beach wear, but by 1932 fashion periodicals began to suggest them for tennis use
Knee-length hose..	Paris, about 1934	Reintroduced in Paris by Clarks Laboratories, offering to United States trade followed almost immediately

Paris with the adaptation manufactured and sold by American firms. In the third place, some origination takes place in the United States. This is truer perhaps in the nonclothing field[1]—as for automobiles, radios, home appliances, etc.—than in the garment lines. The streamlining of such merchandise offers a good example.

The rounded shoulder, wider hip, longer length, and fuller skirted garment introduced into the American market in 1947 indicates that Paris still has an influence on the fashion picture. However, two points should be emphasized in this connection. (1) This change was bound to come even without the Parisian influence, if only because of the reaction against wartime restrictions, although perhaps not as soon or precisely in the same manner.[2] Reportedly, "Designers [connected with motion picture studios] knew that there would be

[1] Undoubtedly some clothing styles originate here at home, particularly in the sportswear field. Some also originate in other American countries, such as Mexico (huaraches, for example). In some fields (*e.g.*, rugs) the Asiatic influence predominates. The Oriental influence, incidentally, appears to be manifest also in "wedgies" (the solid-shank ladies' shoe so popular in America in the early and middle 1940's).

[2] One student of fashion explains the change in terms of the desire of women to return to styles which emphasize feminine characteristics after having taken men's place in business and industry.

some kind of trend in women's fashion after wartime restrictions were eased . . . [and, in making pictures for future showings] they were inching up on the 'new look' before Paris even heard of it. . . ."[1] (2) As might be expected from the foregoing discussion, the "New Look" garment produced by our dressmakers is more conservative than the European model—for street wear, at least. The style is *adapted* to the peculiarities of this country. The American model places much less emphasis on the wide hips and the rounded shoulders, while limiting the fullness and lengthening of the skirt as compared with the original creation. However, one cannot tell at this writing how the trend will develop.[2]

The social and individual costs of fashions are high. In the case of durable goods, fashions may lead to the discarding of articles that are still suitable for use but are made obsolete by the change. If a coat, for example, is a serviceable one, it still continues to be useful regardless of the fashion change. To the extent that goods capable of rendering efficient service are cast aside because they are no longer fashionable, fashion is wasteful. The uncertainty as to changes in fashion and the unpredictableness of the particular style that is going to prove popular increase the risk and hence the cost of the merchant's business. The degree of risk depends to some extent on the stage of acceptance of a style, however. Thus, those selling a newly accepted item assume a greater burden of risk than those selling a well-established item.

The manufacturer also incurs risks because of style changes. The goods he produces may often prove unsalable. Also, more expense may be involved in the production of the goods because of the special methods required. For example, in the case of style shoes the cutting must be done by hand, whereas the cutting for standard models can be done by machine. The discarding of goods before they have completed their usefulness means that a greater number of productive forces are necessary to produce them; hence means of production are drawn away from other uses where they might be employed to increase the quantity of goods to be consumed, and in consequence the total product of society is lessened.

Producers endeavor to maintain as much control over fashions as possible, in order to lessen their risks and to manipulate the changes

[1] *Business Week*, Sept. 20, 1947, p. 32.

[2] Mainbocher believed (in December, 1947) that the next two years would be a transition period and during that time "all sorts of styles will be seen," but that by the end of that period the trend might have acquired definition and direction.

to their advantage. The production of styles in women's clothing has, for example, become highly commercialized. New designs are shown at the openings of the *couturiers* in February and August. If the design can be sold to a royal or titled person or a popular actress, it may prove a success. Another means of attracting attention to the design is to exhibit the clothes on models or mannequins who appear at the races or on the boulevards of Paris. Cloak and suit makers, buyers for department stores, and representatives of American textile mills make a practice of attending functions at which the creations of the *couturier* are displayed.

Manufacturers of specialized raw materials are anxious to see styles demanding the use of their products and, in consequence, often carry on aggressive campaigns in favor of certain styles. For example, in 1919 a large shoe-button manufacturing concern conducted a campaign through unnamed advertising in trade journals purporting to be announcements that buttoned shoes were returning to vogue. At the same time, a campaign to maintain the style of high shoes for women was being carried on by a manufacturer of kid leather, which is the only kind of leather that can be used successfully in the tops of very high shoes. At the same time that this effort was being expended in high-shoe propaganda, another campaign was carried on by a number of companies favoring large numbers of colors in women's shoes. All the companies taking part in this campaign were engaged in the manufacture of colored leather. Besides these campaigns for special interests, the shoe trade and other trades have carried on campaigns in behalf of the whole industry in regard to certain styles or style policies.

The fashion cycle has an important effect upon merchandising in that a merchant must decide upon the particular phase of the cycle in which he is to operate and must adjust his sales appeals and policy accordingly. In the first portion of the cycle, goods are sold to the leaders or determiners of the fashion. Here the appeal must be to distinctiveness or differentiation from others. The second phase appears when those who closely follow the changes adopt the styles. Here the sales appeal is directed to emulation or feeling for the up-to-dateness of the article. Finally comes the stage of general adoption, reached when the style becomes set and sales become large and fairly certain and can be made at lower prices. The appeals of this stage are generally those of economical emulation and are based on the idea that a person can now inexpensively follow the style leaders. The individual merchant must decide in which of these phases he is to operate, as his establishment must become associated in the mind of

the public with one of these particular phases. Attempts to operate in more than one phase are rarely successful.

It is interesting to note that Americans are probably the most fashion-conscious of all peoples. This situation is not difficult to explain. (1) There is a greater diffusion of wealth here than elsewhere. That is to say, people can buy new things if they so desire. (2) Americans are, on the whole, more cognizant of what is going on about them. In other words, because of education, newspaper and periodical reading, travel, movies, etc., they know almost immediately about the new things offered. (3) Americans are freer from custom and tradition than most peoples. This means that desires are not checked by reactionary influences.

The American people are not quite so irrational in fashion matters as they once were, however. Practicability has become extremely important as a factor conditioning the success of a fashion. The reason for this, of course, lies in the modern trend toward freedom of movement and out-of-door activities for young and old. Thus we would never expect a reversion to the hobble skirt in this day and age. Moreover, consumer-buyers are displaying a more rational attitude toward fashion in other ways. For example, the white vestee extremely popular in high- and medium-priced dresses some time ago proved unpopular in the very low-priced dresses because in the latter the vestee was machine-stitched and could not be removed for cleaning, which meant that the buyer of a $3.95 dress had to incur a cleaning cost of $1 every time the vestee became soiled. Again, fur coats in swagger lines received wide acceptance among those with higher incomes in the early 1930's, but when executed in lower priced garments had to be toned down because the lower income classes demanded a coat that would not be conspicuously out of fashion within a relatively short time. This is likely to be true generally, except when incomes are so high even among the relatively low-priced groups as to make caution unnecessary.

Thus, there is evidence leading to the conclusion that Americans are not victims of fashion to the extent that it is popularly supposed. Practicability—a rational factor—is making definite headway as an important determinant of style acceptance. This, indeed, is an encouraging sign. However, we probably have a long way to go before women can be said to have freed themselves from enslavement by fashion movements.

Elizabeth Hawes in her book, "Fashion Is Spinach," condemns the institution of fashion as follows:

"I don't know when the word fashion came into being, but it was an evil day. For thousands of years people got along with something called style and maybe, in another thousand, we'll go back to it. . . .

"Style in 1937 may give you a functional house and comfortable clothes to wear in it. Style doesn't give a whoop whether your comfortable clothes are red or yellow or blue, or whether your bag matches your shoes. Style gives you shorts for tennis because they are practical. Style takes away the wasp-waisted corset when women get free and active.

"If you are in a position to deal with a shop which makes your clothes specially for you, style is what you can have, the right clothes for your life in your epoch, uncompromising, at once.

"On top of style there has arisen a strange and wonderful creature called fashion. . . . Fashion is that horrid little man with an evil eye who tells you that your last winter's coat may be in perfect physical condition, but you can't wear it. You can't wear it because it has a belt and this year 'we are not showing belts.'

"Fashion gets up those perfectly ghastly ideas, such as that accessories should match, and proceeds to give you shoes, gloves, bag, and hat all in the same hideous shade of kelly green which he insists is chic this season whether it turns you yellow or not. Fashion is apt to insist one year that you are nobody if you wear flat heels, and then turn right around and throw thousands of them in your face.

"Fashion [in short] persuades millions of women that comfort and good lines are not all they should ask in clothes. Fashion swings the female population this way and that through the magic expression that 'they' are wearing such and such this season and you must do likewise or be ostracized."[1]

This picture by one of America's foremost clothing designers indicts the institution of fashion as practiced in the United States and suggests that it is an important source of consumer waste. It would seem that America's women require further education along these lines.

2. Variations in Consumption as among Income Classes. Though the subject of consumer expenditures is more properly discussed in another connection (Chap. XII), it seems advisable at this point to inquire into the effect of income on the consumption of certain types of items. Since the Federal government a few years ago allocated WPA funds for investigatory work, much interesting information is at hand on this subject. One study, "Consumer Use of Selected

[1] ELIZABETH HAWES, "Fashion Is Spinach," pp. 5–7.

Goods and Services, by Income Classes,"[1] is particularly pertinent in this connection. The basic data were collected by means of a house-to-house property inventory of 64 cities and reveal many interesting facts.

There is little doubt of a very definite relationship between income and the consumption of particular items. For example, automobiles, though now a necessity for a large percentage of the nation, were not owned by 40 to 60 per cent of the reporting families. As might be expected, most of the families that had no automobile were of the low-income groups. More specifically, approximately three-fifths (or more) of the no-car families had incomes of less than $1,000. Since in every city even the lowest income class had many car-owning families, the influence of income on car ownership is more effectively revealed by the steady decrease, noticeable throughout the range of income classes from the lowest to the highest, in the percentage of families having no car.

The relation between income and the use of mechanical refrigerators is similarly manifest. This is revealed by the fact that despite the relatively low percentage of groups having incomes of $2,000 or more, two-fifths of the families reporting mechanical refrigerators in each city had incomes of not less than $2,000. Moreover, the percentage of users in any one income class (below $5,000) tended to exceed the percentage of users in any lower group. Since, however, there was a relatively small number of families in the higher classes, the bulk of mechanical refrigerators were held by those with incomes between $1,000 and $3,000.

One would think offhand that everyone has the benefit of modern bathing facilities. But such is not the fact. The survey revealed that, though in some cities the percentage not having such facilities in their homes was only 4 per cent, in others it was much higher. Indeed, in Greensboro, N.C., according to the study, bathtub or shower installations were lacking for 43 per cent of all reporting families. The absence of installed bathing equipment is definitely associated with low incomes. Irrespective of race, most of the families reporting no installed equipment had incomes of less than $1,000. As a general rule, furthermore, the percentage of families without installed bathing facilities tended to diminish in each succes-

[1] The one from which the information in this section is drawn—Market Res. Ser. No. 5.12—covers Cleveland, Ohio: Decatur, Ill., Lincoln, Nebr., Sioux Falls, S.Dak., Topeka, Kans., Wichita, Kans., Asheville, N.C., Greensboro, N.C., Hagerstown, Md., Wheeling, W.Va., Baton Rouge, La., Wichita Falls, Tex., Boise, Idaho; Butte, Mont., Phoenix, Ariz., Sacramento, Calif.

sive income group from the lowest to the highest. Conversely, there is a general tendency for each successively higher income class to have a greater proportion of families with two or more tubs.

Income has a direct bearing on the use of heating facilities also. This relationship is indicated by the fact that, in cities where central heating plants were used to an appreciable extent, the percentage of families reporting the use of heating stoves tended to decrease in each successively higher income class. Moreover, from 60 to 80 per cent of all reporting families using stoves reported incomes of less than $1,000. Conversely, there is a definite tendency for each successively higher income class to have more homes equipped with central plants than the group immediately below.

The income-and-consumption relationship obtrudes itself even at the level of the bare necessities. In the use of fuel for heating, the relatively few wood-burning families were those having less than $1,000 per annum. Oil is used in a larger percentage of families as incomes increase. In the matter of cooking fuel: in each city of the study the proportion of people using gas for cooking in any income class below $3,000 tends to be larger in each higher income group. In cities showing an appreciable use of electricity for cooking, a similar relationship is indicated.

Income, then, materially conditions the consumption of certain commodities. Wants arising out of fundamental requirements are satisfied in varying ways according to the amount of money available for expenditures. Moreover, there are many individuals whose wants are satisfied in a very inadequate manner at the present time. Some of this, no doubt, is due to scarcities of goods. Some, however, is probably due to the chronic economic ineffectiveness of the breadwinner of the family. In some instances, no doubt, consumption difficulties arise out of inefficiency in purchasing and through poor household management. That is to say, the family with small income chooses to maintain a motorcar, say, rather than to provide more effectively for their more fundamental requirements.

3. Variations in Consumption as among Periods of Time. The consumption of a particular commodity over a period of time varies because of changes in the demand for the commodity or because of changes in its price. These causes are so closely connected in practice that it is nearly impossible to distinguish between them. The principal causes of changes in demand are (1) changes in the income of the people, (2) the growth of population and changes in its composition, and (3) changes in the habits of the people. The results of changes in the incomes of consumers have been outlined in Chap. III;

the results of the growth of population and the changes in its composition are considered somewhat at length in Chap. XX; some of the demand relations of commodities and results of their changes are taken up in the present chapter.

Changes in the prices of products, in the sense in which we are dealing with the problem here, to some extent at least arise from changes in production costs of a given quantity of product. When these costs are compared over a long period of time, many changes are found to have taken place. Inventions and improvements have reduced the cost of many commodities, formerly luxuries, until they are now necessaries. Two general classes of goods stand out, those which have historical decreasing costs of production and those which have historical increasing costs of production. These costs are not absolute but are relative to one another. There are very few commodities for which the absolute costs have risen. The general group that represents the commodities having historical increasing costs is that of agricultural products. Manufactured products as a group represent historical decreasing costs. When an index of prices of agricultural products and an index of the prices of manufactured products are compared for any considerable period of time, the price of agricultural products is found to rise steadily relative to manufactured products. This means, of course, that the costs of producing manufactured products have fallen much more rapidly than the costs of producing agricultural products.

General changes in the consumption of particular articles are evident wherever we have the data. Unfortunately these data are somewhat meager, and all that can be done at present is to show the situation with regard to certain products. Within recognized data limitations, an attempt is made to show three sorts of regular changes: (1) long-time changes, called *trends*, (2) fluctuations above and below the long-time trend, called *cyclical fluctuations*, and (3) regular fluctuations within the period of a year, called *seasonal fluctuations*. Besides these regular changes there are occasional irregular or sporadic changes.

In an economic society such as ours—a society based upon freedom of enterprise—tremendous changes occur over a period of time. Consumption habits change owing to the introduction of new commodities, to changes in the income of the members of society, and to altered conditions of life. Thus automobiles, radios, rayon, and electrical refrigeration are products of the present century, and their introduction has had a marked influence on our consumption patterns.

Moreover, these products have displaced other products (horse-drawn vehicles, phonographs, silk, and ice). Progress thus makes for dislocation of industry, but is necessary if we are to accept improvement.

Table 38 gives indexes of the number of units of selected goods and services produced in the early 1940's as compared with the early

TABLE 38. INDEXES OF THE NUMBER OF UNITS OF SELECTED ITEMS PRODUCED IN THE UNITED STATES IN THE EARLY 1920'S AND EARLY 1940'S*

	Early 1920's, except airmail	Early 1940's
Air mail carried†	100	835
Cigarettes‡	100	713
Electric energy§	100	510
Electrical refrigerators (estimated)‖	100	52,000
Gasoline¶	100	577
Passenger automobiles¶	100	196
Printing and publishing**	100	151

* Adapted from the "Statistical Abstract of the United States, 1944–1945" (Tables 484, 930, 492, 877, 507, and 897), except for data on electrical refrigerators, which were taken from N. H. Borden, "The Economic Effects of Advertising," p. 397.

† 1935–1943 ‖ 1921–1940
‡ 1920–1943 ¶ 1920–1941
§ 1920–1943 ** 1925–1941

1920's. The changes shown are indeed striking. In this relatively short period increases of several hundred per cent or more have appeared in most of the items listed, during a time when population was increasing at a rate of only 1½ per cent per annum. The increases in air mail carried and in cigarettes and gasoline produced are striking, while the increase in electrical refrigerators manufactured is phenomenal.[1]

[1] The percentage of wired homes owning refrigerators, washing machines, vacuum sweepers, and electric ranges over a period of years follows:*

Year	Per cent			
	Refrigerators	Washing machines	Vacuum sweepers	Electric ranges
1925	Less than 1	21	31	3
1931	17	41	45	5
1938	52	58	49	10

* TNEC Monograph No. 1, "Price Behavior and Business Policy," 1940, p. 118.

For some of these products and for certain others, additional data obtain. For example, the per capita consumption of silk in the United States increased almost 400 per cent during the quarter-century from 1900 to 1925. Within the decade just preceding the Second World War, however, artificial silk gained tremendous headway, until by 1935 the value of rayon manufactures was 35 per cent higher than the value of silk manufactures. During the war, of course, silk production ceased entirely, and it may never recover from this blow.

Consumption patterns have altered greatly in other fields as well. For example, the ready-to-wear business, practically unknown 50 years ago, is now one of our foremost industries. The value of the product of manufacturers of women's and misses outer clothing was over one billion dollars in 1939.[1] The large bulk of our clothing, once made at home or in custom establishments, is now sold ready to wear.

Similar changes have occurred in other phases of our economic activities. Thus, although the number of passenger automobiles (and taxis) registered in 1910 was only a little over 450,000, that figure had reached 32,557,000 by 1941.[2] As further evidence of the dynamic nature of our society, the annual mileage of automobiles has increased from almost nothing at the turn of the century to well over three hundred billion miles at present. The increase in the use of radios is another twentieth-century phenomenon. One can hardly credit the changes that have occurred in this field. Here is an industry, practically nonexistent in 1920, which during the subsequent quarter-century had placed enough sets in homes so that by 1945 over 56 million were in use.[3] No wonder the motion-picture industry, which was considered "depression-proof" in earlier years, found itself in the trough of recession just before the Second World War!

Accompanying the foregoing changes have appeared others equally important. Although there are few data showing the growth of newspaper and periodical consumption over an extended period, the few figures we have indicate important changes here also. For example, the circulation of newspapers in the United States increased 60 per cent from 1922 to 1946.[4] Periodicals—weeklies, class, general

[1] U.S. Census, 1940: "Census of Manufactures, 1939," vol. II, Part 1, p. 432.

[2] This declined to an estimated 25,137,000 cars registered by 1945 because of the war. *World Almanac*, 1946, p. 649. Incidentally, the world total according to the Almanac was only 45,376,000 in 1941, when registrations in the United States were 32,500,000!

[3] *Ibid.*, p. 612.

[4] N. W. Ayer, *American Newspaper Annual and Directory*, 1922 and 1946.

monthly, and women's—also showed changes. While adequate figures are lacking here, in the twenty years from 1917 to 1936 there was almost a 100 per cent increase in the circulation of thirty periodicals of unspecified type.[1] The increase in total magazine circulation during the past 25 years was probably at least as great as in newspapers.

Interestingly enough, actual trends can be discovered in eating habits, also. Table 39 indicates such changes. It may be seen that

TABLE 39. PER CAPITA CONSUMPTION OF CERTAIN FOODS IN THE UNITED STATES AT FIVE-YEAR INTERVALS*

Year	Meats, lb.	Eggs	Dairy products except butter, milk equiv. qt.	Fats and oils, lb.	Potatoes and sweet potatoes, lb.	Grain products, lb.	Citrus fruits and tomatoes, lb.	Other fruits and vegetables, lb.
1910	157	297	160	59	209	306	44	279
1915	143	304	169	62	194	279	51	299
1920	144	290	187	57	166	249	54	313
1925	147	309	193	65	160	233	59	293
1930	137	319	199	67	146	226	60	304
1935	128	270	198	60	159	195	77	312
1940	148	306	215	71	139	192	95	329
1945	157	374	257	60	143	204	119	370

* "Nutritive Value of the Per Capita Food Supply, 1909–1945," U.S. Dept. of Agriculture (mimeo.), June, 1946, p. 4.

increases have occurred in the consumption of dairy products, eggs, fruits and vegetables, decreases in potatoes and cereals. From other sources one is able to conclude that the per capita consumption of meat declined during the first 30 years of the present century, although the late war seems to have affected these trends in varying ways. Part of this is due, it is thought, to a reduction in the need for a heavy diet resulting from increased use of the automobile, part to the use of small apartments in which meats are inconvenient to prepare, and part to installment selling and its rigid enforcement of economy in food purchase.[2] Whatever the causes, there is no gainsaying the partial replacement of meats by fruits, vegetables, and salads in the dietary program of American consumers.

[1] HUGH E. AGNEW and WARREN B. DYGERT, "Advertising Media," p. 97.

[2] RALPH F. BREYER, "Commodity Marketing," p. 205.

As was mentioned previously, the consumption of goods varies with the ebb and flow of business activity also. Though cyclical variations in consumption have not been studied very completely, we know that such variations are largely matters of changes of income. All articles are not, of course, similarly affected. Staple food products remain relatively constant, but clothing and shoes fluctuate quite definitely. In general, as indicated in Chap. IV, the volume of transitory goods acquired remains relatively constant in time of depression, whereas the volume of durable consumption goods

TABLE 40. SEASONAL VARIATIONS IN RETAIL SALES IN DIFFERENT TYPES OF STORES[1]

Kind of store	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
Department...	87	77	100	104	103	100	75	78	91	112	113	160
Mail order.....	99	91	115	100	87	84	74	77	97	128	126	122
Grocery chain..	100	95	106	101	98	96	98	97	97	105	102	105
Five-and-ten-cent........	72	75	95	95	96	92	92	96	94	108	94	122
Cigar chain....	88	86	96	96	101	96	99	97	99	107	100	135
Drug chain....	97	91	100	98	98	98	101	100	99	102	94	122
Shoe chain.....	75	68	96	121	116	106	95	79	92	113	110	129
Music chain...	84	85	93	86	82	78	75	88	102	119	121	187
Candy chain...	84	85	96	102	97	92	98	101	100	103	95	147

[1] H. B. VANDERBLUE, "Problems in Business Economics," p. 65.

acquired declines drastically, although there are some exceptions. The sales of the latter type of products are, of course, only an imperfect index of their consumption. What actually happens, in some instances, is that old durable goods are utilized longer in time of depression. Utilization, therefore, might actually remain constant even with a drastic decline in sales volume.

The last type of consumption variation in point of time is that which appears more or less regularly within the year. Thus the consumption of many articles varies seasonally, and though retail sales are not always concomitant with consumption they indicate it fairly satisfactorily in some instances. For most retail products there is a marked seasonality in sales. Table 40 shows the seasonal variations in retail sales for a number of different types of stores.

In most of these lines, there are pronounced seasonal movements. There are generally two periods of dullness in most lines, the first during January and February, and the second during July and August. There is usually a considerable volume during the spring months and

an increase in volume during the fall, which reaches a peak in December. The winter dullness is most pronounced in the five-and-ten-cent and shoe stores. The midsummer inactivity affects the department stores, mail-order houses, and music stores particularly. The candy and drugstores have considerable hot-weather business. Figure 12 shows the variations during 1936 and 1937 in the sales by department stores located in various portions of the United States.

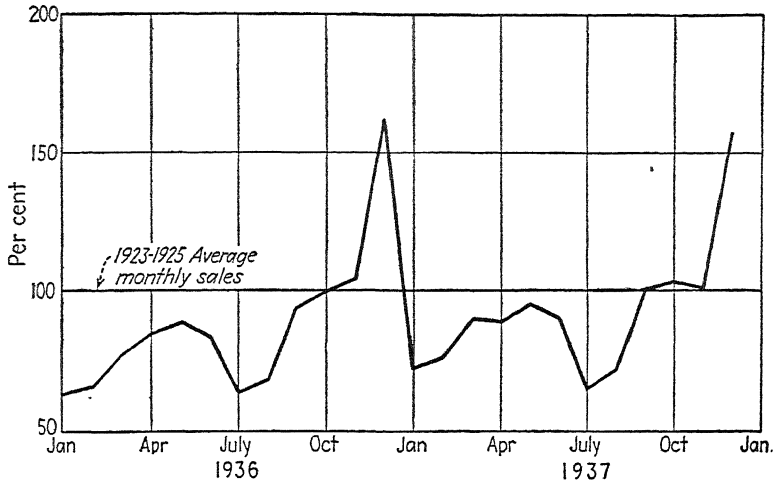

FIG. 12. Seasonal variation in department store sales in the United States, 1936–1937.

This is, in general typical of department store sales behavior regardless of the year. This graphic presentation of seasonality illustrates both the reasons for and the relative lack of success of department-store special events. The various lines making up the total sales have different seasonal variations, as is shown in Fig. 13, of the sales of men's clothing and women's dresses in New England department stores.

Particular commodities, likewise, show distinct seasonal variations in consumption. The charts in Fig. 14 show some of the variations in the consumption of milk and cream in greater New York City. Milk and cream are particularly good examples, because a constant price is maintained throughout the year and variations in sales show true changes in demand. The graph for milk shows a peak of consumption in the warm months with consumption falling off on either side in the cooler months. The heavy-cream curve shows a peak in May and June during the berry season, with a very great slump in

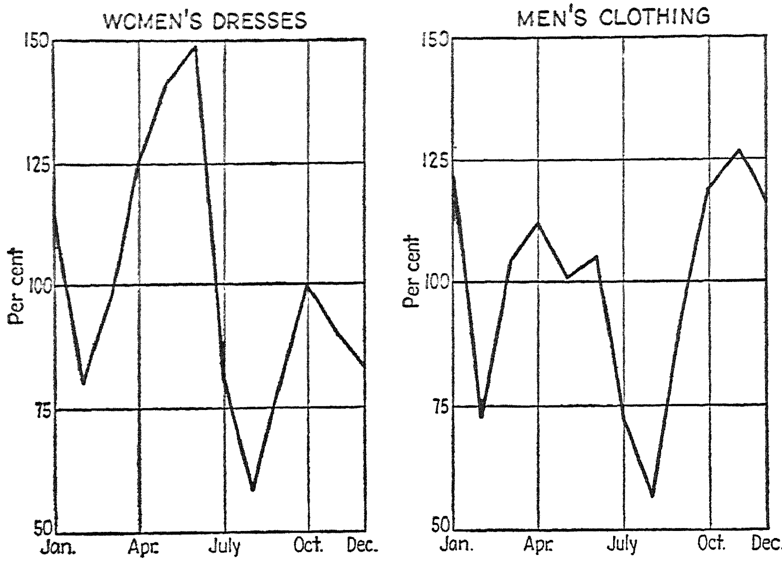

FIG. 13. Seasonal variation in sales by New England department stores, 1926–1930.

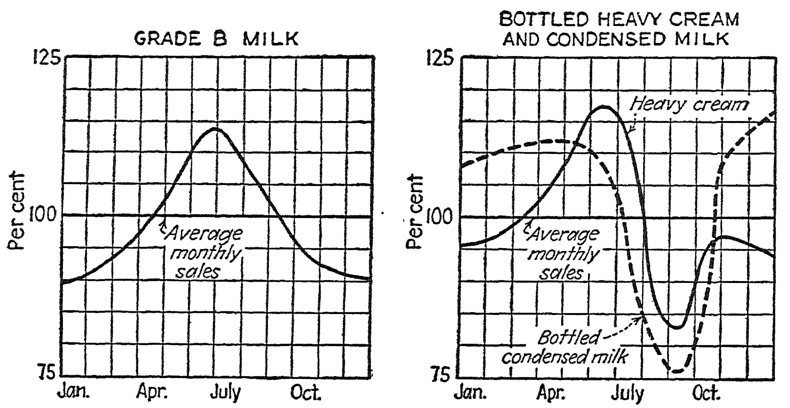

FIG. 14. Seasonal variations in sales of dairy products in greater New York.

August and September during the vacation period. Consumers of heavy cream are in a high enough income group customarily to take vacations. The condensed-milk-sales curve is explained by the variations in coffee drinking, canned condensed milk being purchased by many New York consumers for use in their coffee instead of cream. Coffee drinking, of course, falls off materially during the warm weather.

4. Variations in Consumption as among Places. Finally, the consumption of articles varies greatly as among places. A great many

factors are responsible for these differences. Differences in nationality, income, price of products, climate, occupation, age, and composition of populations are all important. As was suggested previously, one of the most important conditioning factors is income, since, without it, goods may not be acquired even though they are desired.

There appear to be vast differences in income in different places. Thus, according to the figures in Table 41, income varies tremendously among countries. The data given in the table, while the

TABLE 41. PER CAPITA INCOME ESTIMATES FOR VARIOUS COUNTRIES*

Country	Year	Per capita income, current dollars	Per capita income, 1913 dollars
United States	1928	749	541
United Kingdom	1928	411	293
Germany	1928	279	199
France	1928	192	188
Italy	1928	121	96
Russia	1929	107	62
Japan	1925	89	53

* SIMON KUZNETS, National Income, "Encyclopaedia of the Social Sciences," vol. 11, p. 206.

latest available, are somewhat old although they have the advantage of depicting the situation before the devastating effects of the Second World War. The war undoubtedly accentuated the differences between the United States and foreign countries; moreover, differences among various foreign countries have very likely changed because of the uneven impact of hostilities.

The variations shown in Table 41 are explained to a large extent by differences in the extent and quality of natural resources. Some of them, too, are due to differences in technical skill among the workers of the several countries. Variations in the degree to which capital equipment is used and the efficiency of the type of production organization under which industry works are also important. That the United States leads in most of these matters there is little doubt. That income is higher in the United States than in other countries is similarly manifest.

Income is not uniformly high in the United States, nor are consumption patterns the same from region to region. Table 42 gives data in support of this contention.

These indexes, based on average per capita data, bring into bold relief the differences among geographical regions. In general the

South Atlantic, East South Central, and West South Central regions appear to be at a disadvantage in comparison to the New England, Middle Atlantic, and Pacific Coast regions, if inferences drawn from the data can be accepted as sound.

The figures for wired homes and radio ownership are indicative of a certain manner of living or pattern of consumption. The factor of wired homes is a particularly important index of consumption in that

TABLE 42. INDEXES OF PER CAPITA WIRED DWELLINGS AND RADIO OWNERSHIP IN 1940, AND SALES OF FOOD STORES, APPAREL SHOPS, FILLING STATIONS, RESTAURANTS, AND DRUGSTORES IN 1939, BY REGIONS OF THE UNITED STATES*

(Expressed as a per cent of the average per capita figure for each series)

Geographical regions	Dwellings wired for electricity, 1940	Dwellings with radios, 1940	Retail sales				
			Food stores	Apparel shops	Filling stations	Eating and drinking places	Drugstores
New England	127	110	141	143	100	124	119
Middle Atlantic	127	112	134	165	77	156	94
East North Central	109	113	103	113	86	92	94
West North Central	97	105	84	83	117	96	103
South Atlantic	71	70	69	69	82	52	77
East South Central	53	61	69	69	59	36	60
West South Central	68	72	68	65	86	60	94
Mountain	103	98	95	69	145	116	119
Pacific	143	128	139	130	154	160	136

* Adapted from the Rand McNally "Commercial Atlas and Marketing Guide," 1946, p. 29.

certain types of goods can be consumed only if the home is wired. Thus electrical appliances, most mechanical refrigeration, and modern radios cannot be used if electrification is absent.

Radio ownership is interesting also because it indicates to a limited extent at least the ability to acquire luxuries. As can be seen by the figures in the table, the distribution of sets varied materially among sections. The largest proportion of families with radios is found on the Pacific Coast and the smallest in the East South Central section.

These variations appear also in retail sales of consumers' items such as foods, wearing apparel, gasoline, and drugs. Some of these differences, no doubt, are due to factors other than income. For example, it is very likely that people on the Pacific Coast do not eat

twice as much or as expensively as those located in the East South Central section of the country. Part of the difference in sales volume, one suspects, is due to the fact that the latter on the average produce some of their own food. Part of the difference in apparel sales can be similarly explained. Some of the differences are due to environmental factors such as larger distances, requiring greater use of the automobile and, hence, gasoline.[1] Most of the differences, though, are probably due to variations in income among the several regional divisions. It should be pointed out, however, that while a *different* way of life is indicated among regions, this does not necessarily mean that a *better* way of life prevails in one area than in another, unless of course adequate supplies of goods and services necessary to maintain physical and mental health are unavailable in certain areas.

Thus we see that variations in consumption occur from group to group, from time to time, and from place to place. Some of these differences are desirable; some of them definitely undesirable. For example, changes in consumption in point of time probably on the whole are advantageous. More and better goods presumably emerge from the dynamic economic process. On the other hand, the differences that are manifest among income groups are very disturbing. It is particularly discouraging when one recalls the fact that there is some tendency for poverty to engender poverty.

Questions

1. Discuss the sources of prestige value in the consumption of goods in modern society.
2. Do you think that the prestige values of the future will be more or less rational? Give the reasons for your answer.
3. How does it happen that fashion is more important than ever before in the United States? Can its existence be justified socially? Explain.
4. A visiting English businessman recently said: "Style is not so important . . . in our economy and the average British manufacturer does not feel a compelling urge to alter his product at frequent intervals. Once he has established his reputation he will turn out the same article year after year until some radical development compels him to change it." Explain why you think this is true in England but not true in the United States.

[1] The student is urged to look for other inferences concerning the contrasts in manner of living among regions, from data in the table. Are there significant differences not mentioned in the text? To what factors are such differences attributable? What other series of data might be helpful in revealing regional differences on consumption patterns? How about automobile ownership? Magazine circulation? Educational expenditures? Any others?

5. What do you think of the argument that fashion changes are no more wasteful than driving one's own car to the theater would be when one could save money by taking the bus or subway, because each produces satisfaction, which is the end product of consumption?

6. Distinguish clearly scales and standards of living. What is meant by the American standard of living? What determines living standards? Scales?

7. By means of one of the indexes to periodical literature and by interviews with people who have lived abroad for some time, compare as well as you can the way of life of the American mechanic, white-collar worker, or professional man with that of persons in similar occupations in some foreign country.

8. Compare life expectancy in the United States and other countries. In your opinion is there any relationship between life expectancy and scales of living?

9. There are striking variations in consumption as among places, times, and groups. What are the most important factors giving rise to these differences?

10. It appears that the percentage spent for food increased during the war. Does this vitiate the generalization made in another connection that the percentage spent for food declines with increasing incomes? Why or why not?

11. Suppose a certain labor group succeeds in obtaining a 40-hour week at the same take-home pay as when it worked 48 hours; is its standard of consumption likely to be affected thereby? Its standards of living?

12. Would one spending $5,000 per year necessarily have a higher scale of living than one spending $2,500? Explain fully.

13. Write a brief but carefully thought-out essay on the effect of the war on living scales, on the basis of the experience in your own family during the recent conflict.

14. What would you say as to the comparative scales of consumption as between

a. Two individuals who consume about the same amount and quality of goods and services, but one spends 25 per cent more than the other because of carelessness in purchasing.

b. Two individuals who have about the same income, but one buys a new car each year while the other keeps up his old one and saves the balance.

c. Two individuals, one having 25 per cent more income than the other, both of whom, however, consume about the same amounts of goods and services, since the individual with lower income utilizes public facilities more (rides through the park in a bus, say, rather than through the country in a car; uses the public library instead of purchasing his own books, etc.).

d. Two individuals with approximately equal income, both of whom have fine gardens, but one spends $25 per month for a gardener, while the other performs the gardening task himself. Would you say that any of these paired individuals has a "higher" scale than the other? If not, how would you distinguish them? Explain fully.

15. Is there any relationship between standards of living and happiness? Explain fully.

16. In the light of the discussion in the first part of this chapter, what in your opinion is the meaning of the term *American standard of living?*

CHAPTER XIV

CONSUMERS' PURCHASING HABITS AND THE MARKETING SYSTEM

Marketing is the group of activities that are involved in the flow of goods and services from the point of production (in the narrow sense of the term) to the point of consumption. Marketing has to do with the creation of time, place, possession, and information utilities; *i.e.*, it actually produces want satisfactions, since the mere creation of form utility does not complete the production cycle. The consumer should dispel the notion that the marketing system is a useless appendage to a very vital production system. There are many invaluable tasks that must be performed in order that goods and services be made available to consumers. Anything that affects the efficiency of the system is worthy of consumer attention. The marketing system has been the target of a great deal of adverse criticism by layman and economist alike. It is essential that the person interested in consumer problems should have a sound understanding of the organization and operation of the system. Without such a grounding, competent criticism is impossible.

The tasks performed by the marketing system are termed *marketing functions*. To these we shall turn our attention for a moment.

The functional approach to the subject of marketing is useful, since not only is it a timesaver, in that one no longer needs to study the marketing systems of scores of commodities in order to understand fundamentals, but it also gives one perspective in thinking about the subject, since the basic functions must be undertaken by someone *regardless of the economic order under which the marketing system works.* There are, in other words, certain fundamental tasks that must be undertaken if goods and services are to be completely produced. These tasks are as follows:

I. Functions of Exchange
   1. Buying:
      a. Determining the consumer requirements—amounts, styles, sizes, etc.
      b. Seeking out sources of supply
      c. Assembling goods at the proper time and place

2. Selling:
   a. Seeking out buyers
   b. Informing and persuading prospective buyers
   c. Arranging prices and titles
   d. Dividing, packing, and arranging delivery

II. Facilitating Functions
1. Financing:
   a. Furnishing capital for purchasing merchandise
   b. Arranging credit
   c. Carrying accounts
   d. Making collections
2. Standardization (the setting up of tests—size, quality, or whatnot—for the purpose of making grading possible)

III. Physical Functions
1. Grading (classifying goods according to accepted standards):
   a. Making possible sale by description and sample
   b. Reducing storage and transportation costs by eliminating unsalable products
2. Transportation (the medium making specialization of area possible):
   a. International and interstate and intercity movements of goods
   b. Intracity deliveries
3. Storage:
   a. Making possible supply of goods at the time and place required by the consumer
   b. Improving or protecting quality of goods
   c. Making possible the awaiting of more favorable demand conditions

IV. The Universal Function
1. Risk-bearing—marketing institutions must bear the risks of:
   a. Price changes
   b. Physical damage or deterioration
   c. Changes in demand
   d. Liability, etc.

From the preceding tabulation it can be seen readily that there are actual necessary services which must be performed by the marketing system in order that goods be made available for consumption. It must be remembered that goods which are not known to exist or are not needed at the moment or are thousands of miles away and in someone else's possession are of little use to the consumer. The process of making their existence known, of holding them until needed, of getting them to the place where they are to be used, and of effecting transfer of ownership are as essential to their use as the actual production of the goods.

As to the question of who performs the various functions, no satisfactory generalization can be made. Presumably all marketing functionaries aid in some degree. Were it not so, competition would force them out of the system, although it must be admitted that this

elimination process might be quite slow. Channels of distribution are made up of various types of individuals and institutions, and the specific method of distribution of any one product depends upon relative costs and the relative effectiveness of the several alternative methods that are available.

It is often argued by the layman that costs of marketing are much higher than they should be because there are too many middlemen. Such a statement reveals a lack of understanding of the system. Though it may be true that there are too many middlemen in some instances, it might well be argued that there are too few in others. Many commodities could not be efficiently distributed by direct methods. Certainly no one would argue that the California grower of iceberg lettuce would be better off if he were to market his commodity directly to consumers located in New York City. Anyone taking such a position fails to recognize the tremendous economic gains to be derived from specialization of effort.

1. Consumer Buying Habits. The goods that the consumer purchases fall quite readily into three classes when considered on the basis of his buying habits. These are called *convenience* goods, *shopping* goods, and *specialty* goods. Convenience goods are those which the consumer purchases in the most convenient manner possible. Convenience may be related to one's home or one's place of work or, indeed, may not be in terms of proximity at all, but in terms, say, of easy accessibility by motorcar. The category generally comprises things of low unit value purchased at frequent intervals. Such items as bread and other staple groceries and tooth paste fall into the convenience-goods class. Shopping goods include those which the typical consumer desires to compare in price and quality in a number of establishments before purchasing. They usually are relatively expensive items, purchased infrequently. Style goods, such as women's clothes and furniture, are examples of such merchandise. Specialty goods, finally, are those which are sufficiently different from other goods in the same class to possess reputation enough to cause the consumer to go to a considerable inconvenience—usually to a particular firm—to purchase them. Automobiles, typewriters, and radios often fall into this class. One Los Angeles concern had the exclusive distribution of the Steinway piano in southern California for many years; this is an excellent example of a product sold on a specialty basis. Hence grocery stores are known as convenience institutions; department stores as shopping institutions; and radio shops as specialty institutions.

These classifications have three interesting and important aspects:

1. They are not universally applicable in all individual consumer situations. For example, one consumer may be a connoisseur of bread or of cheese, say, and may not be satisfied to purchase such items at the nearest store; rather, he goes to some store which he has found carries the quality of item he likes, even though it be a considerable distance from his home or place of work. On the other hand, some individuals buy radios on a shopping basis, comparing prices and qualities in any number of establishments before deciding which one to buy. In classifying an article according to the foregoing three-way classification one means that the item is predominantly of a certain type, and not that every single individual buys it in the same manner.

2. Specialty institutions are not, as is sometimes thought, necessarily the higher priced establishments. For example, Penney's is a specialty institution for some consumers who, when needing shoes or sheets or some item of children's clothing, perhaps, go directly to this store to make the purchase, although they possibly become specialty buyers through experience gathered as a result of the shopping process.

3. Shopping has to do with a comparison not only of prices among various institutions, but of merchandise qualities also. Indeed, at times price does not even enter into the calculation, although this may be rare. The point is, however, that one is typically attempting to compare values (prices and quality) in order to obtain the best item for the money. He is, in short, attempting to make the most advantageous purchase in terms of money expended and merchandise received.

Consumer buying habits have a very important bearing on the lines of merchandise handled by various types of retail institutions. Among the several factors influencing the merchant's selection of lines to carry (including the availability of adequate space for display and storage, financial requirements involved, servicing required of merchandise after sale, the markup one may expect in relation to costs of doing business, the suitability of the store's location for the sale of such merchandise, etc.) the first probably is that of consumer expectations.[1] The question is: "Do, or will, consumers expect to buy the merchandise in question at, for instance, a department store, a variety chain store, or some type of neighborhood store? Thus in the early 1930's the proposal was made that a large department store

[1] M. P. McNair, C. I. Gragg, and S. F. Teele, "Problems in Retailing," pp. 54–59.

undertake the sale and installation of bathroom fixtures; sale of a complete bathroom was the central objective. The store executives here faced a basic conflict: Would consumers [in great enough numbers] be willing to shift from buying bathroom fixtures through the local plumber or contractor, to buying from a metropolitan department store? . . . . [In this instance] the executives were under

TABLE 43. DISTRIBUTION OF 1,665 FACTORY WORKERS, IN 16 CITIES, BY SPENDING HABITS*

Item	Per cent	
	Muncie	15 other cities
Purchases of small items (food, drugs, etc.) most likely to be made on:		
Pay day	33	18.7
Immediately following pay day	16	22.4
Immediately prior to pay day	....	1.5
Days not necessarily related to pay day	49	54.4
Not known	2	3.0
Items costing more than half the weekly salary most likely to be purchased on:		
Pay day	32	26.6
Immediately following pay day	24	35.3
Immediately prior to pay day	....	1.7
Days not necessarily related to pay day	24	26.2
Not known	20	10.2
Advertisements most likely to be noticed on:		
Pay day	9	5.9
Immediately following pay day	6	6.2
Immediately prior to pay day	18	24.5
Days not necessarily related to pay day	55	56.4
Not known	12	7.0

* *Monthly Labor Review*, January, 1939, p. 104, as reported in *Sales Management*, Dec. 1, 1938, p. 16.

the necessity of attempting to gauge accurately the probable response of home builders and home owners."[1]

So far, we have discussed only the circumstances influencing the patronage of consumers for various types of retail institution. Another phase of the subject of buying habits is the circumstances under which expenditures are actually made by consumers for the goods which they acquire. Table 43, which presents data on spend-

[1] *Ibid.*, p. 58.

ing habits of a sample group of factory workers, provides some evidence along this line. From the data presented it appears that in the majority of cases a substantial percentage of the earnings had been spent by the end of the day following pay day. While a large proportion of the small items, such as food and drugs, were purchased as needed, the more expensive items evidently were contracted for on pay day or the day following. While this situation is by no means thought to be typical of all classes of consumers, it is interesting to note that a substantial group of wage earners buy most of their requirements of certain types of merchandise around pay day. This suggests (but admittedly does not prove) that spending is not as carefully planned among such groups as it could be—that, rather, it is done largely on an impulse basis. One wonders whether such spending habits can have anything but an adverse effect on the amount and quality of goods consumed.

2. The Marketing Process. For the purposes of the student of consumption, little need be said about actual marketing technique. Suffice it to say that there are literally scores of different types of func-

TABLE 44. SALES OF MANUFACTURERS BY PRIMARY CHANNELS OF DISTRIBUTION, 1929–1935–1939*

Channels	Per cent distributed sales		
	1939	1935	1929
Sales to wholesalers or jobbers	26.5	26.2	32.8
Sales to industrial and other large users	25.2	26.4	27.5
Sales to or through own wholesale branches or offices	23.8	21.7	17.5
Sales to retailers for resale	19.9	21.1	18.0
Sales to or through own retail stores	2.8	2.3	2.4
Sales to consumers at retail	1.8	2.3	1.8
Total	100.0	100.0	100.0

* U.S. Census, 1940: "Census of Business, 1939," vol. "V, Distribution of Manufacturer's Sales," p. 7.

tionaries involved—brokers, jobbers, wholesalers, retailers, advertising agents, and whatnot; that some are *functional middlemen* (non-title-takers) and others merchants; that each specializes and presumably justifies his existence at any one time by producing his service in an efficient manner; that markets are of two general types —industrial and consumer.

Tables 44 and 45 give in condensed form the essential facts regarding marketing channels. Table 44, containing data which are

thought to be typical, indicates that direct methods are utilized to an appreciable extent in the sale of some items (*e.g.*, industrial commodities) but that middlemen are used for approximately 60 per cent of the total value of goods handled; that the wholesaler still has a definite place in the marketing picture. Indeed, it will be noted that wholesalers carried a greater proportion of total volume in 1933 than in 1929, which indicates that there are some conditions —*e.g.*, situations of depressed volume—in which the manufacturer

TABLE 45. PERCENTAGE DISTRIBUTION OF SALES IN DIFFERENT TYPES OF STORES, 1929, 1933, 1935, AND 1939*

Types	1939, total retail sales, in thousands, $42,041,790	1935, total retail sales, in thousands, $33,161,276	1933, total retail sales, in thousands, $25,037,225	1929, total retail sales, in thousands, $49,114,654
Independents.....	74.7	73.1	71.3	77.5
Chains...........	21.7	22.8	25.4	20.0
Mail order.......	1.3	1.3	1.0	1.0
State liquor......	0.6	0.5		
Direct selling.....	0.4	0.4	0.4	0.2
Leased departments	.....	0.4	.....	0.3
Utility operated...	0.4	0.4	0.3	0.3
Others...........	0.9	1.1	1.6	0.7
Total..........	100.0	100.0	100.0	100.0

* U.S. Bureau of the Census, "Census of Business, 1935," vol. I, "Retail Distribution," pp. 1–22 U.S. Census, 1940: "Census of Business, 1939," vol. I, "Retail Trade," Part 1, p. 10.

cannot afford to utilize more direct methods but must employ agencies whose total volume is large enough to absorb the burden of overhead. Table 45 shows the percentage of sales through various retail outlets. It is interesting to note in this connection that independent stores in general still do 75 per cent of the total retail business although the chains are continuing to make gains. As will be seen later (Table 52), the chains have made much greater inroads in some fields than in others. Incidentally mail-order houses, representing a more direct method of distribution, handle a relatively small volume. Table 46 indicates the percentage of retail sales volume of business done by each of several types of commodity institutions. It is an interesting commentary on the modern way of life that in the United States, in 1935, although the food-store volume was the largest, sales by automotive and motor-fuel outlets accounted for almost 20 per cent of the total retail sales volume.

One other phase of marketing that should be understood by the student of consumption economics is the nature of the market in the geographical sense. This requires a brief description of market areas. A trade or market area may be of any one of several types, depending upon the stage that a product has reached in the marketing process. A manufacturer's trade area, for example, is usually

TABLE 46. PERCENTAGE DISTRIBUTION OF RETAIL DOLLAR SALES VOLUME BY BUSINESS GROUPS, 1929–1939*

Business group	1939	1935	1933	1929
Food stores	24.2	25.22	27.07	22.07
General merchandise	13.5	13.93	15.54	13.12
Automotive	13.2	13.89	11.53	15.94
Apparel	7.8	8.01	7.68	8.63
Eating and drinking	8.4	7.21	5.71	4.33
Filling station	6.7	5.93	6.12	3.64
Lumber, building, hardware	6.5	5.62	5.36	7.83
Furniture, household	4.1	3.89	3.83	5.61
Drug	3.7	3.72	4.26	3.44
General stores	1.9	3.35	4.38	5.23
Second hand	0.3	0.34	0.42	0.30
Others	9.4	8.89	8.10	9.86
Total	100.0	100.0	100.0	100.0

* U.S. Bureau of the Census, "Census of Business, 1935," vol. I, "Retail Distribution," U.S. Census, 1940: "Census of Business, 1939," vol. I, "Retail Trade," Part 1, p. 4.

very extensive; it may be coterminous with the boundaries of the United States or even larger. A wholesale trade area, on the other hand, is generally less extensive, and a retail area is usually still narrower.

Retail market areas vary in size according to the economic importance of the trade centers that serve them, the number and types of highways tapping the area, the mobility of the residents, the wealth and the standard of living of the population, and the number, importance, and proximity of rival trade centers. The general trade area of a trade center is made up of the individual trade areas of the individual stores in that city. The sizes of these individual trade areas vary even as among different stores handling the same types of merchandise, some (as a result of superior reputation or whatnot) enjoying a wide patronage and others having to be satisfied with a much more circumscribed clientele.

An individual market area is a link in a chain the whole of which is a market in the price-making sense. Because of the influence of

external demand-and-supply conditions, no one market area is a self-contained unit. A person living within the limits of a certain retail trade area does not necessarily make all his purchases within that area. If prices vary enough, he will shift his patronage from one place to another. Because of overlapping areas and the mobility of the average consumer, this usually is not difficult.[1] Nor is the market *center* self-contained from the point of view of supply. Prices charged the retailer by the wholesaler result from supply-and-demand conditions throughout a large area, perhaps the whole of the United States, the conditions in any one component trade area having in themselves no great amount of influence upon the resulting price.

An individual market area, however, has a great deal of influence upon the *price policy* of the merchants located in the trade center. Commodities are produced in innumerable quality lines. Price lines which the merchants feel will be popular with their clientele may vary

[1] During the past twenty-five years, "the average trade area for consumers outside the urban district has been increased from a radius of five or six miles to one of thirty to one hundred and fifty miles. This change is the result of a number of circumstances, all interrelated, no one of which can be considered without regard to the others. The causes of the widening of retail trade areas in a general way can be said to have two aspects, the technological and the psychological. Technological improvements have led to reduction of prices of many commodities and, at the same time, have been important factors in the trend toward increased incomes. A recent study shows an increase of 25 per cent in per capita real income in the United States from 1919 to 1929. The decrease in price of automobiles over a period of years may be cited as an example of reduced prices resulting from technological improvements. The psychological aspect is reflected in a higher standard, as distinguished from scale of living. This change is due in part at least to certain inherent traits in human nature and in part to a tremendous psychological effect of improved communication. The most important specific causes of widening retail trade areas, having in varying degrees technological and psychological implications, are as follows: (1) The increased number and improved quality of automobiles, making it possible for the consumer to travel thirty miles in the time that he formerly traveled five. (2) The increased number of improved highways, which reduces the irksomeness of long distance travel. (3) Increased motion picture attendance, increased number of radio receiving sets, and wide reading, all of which make for increased knowledge and stimulate interest in the newest types of merchandise. (4) The expansion of rural free delivery routes, which now makes it unnecessary for the rural dweller to go to the village for his mail. (5) The tendency of wide areas to become still wider, due to the fact that where trading is concentrated in larger centers rather than scattered among many it is economically practicable to establish chain stores and mail order branch retail concerns, which in turn draw more people from the smaller near-by towns to the larger, more distant towns." RALPH CASSADY, JR., and HARRY J. OSTLUND, "The Retail Distribution Structure of the Small City," pp. 21–22.

from town to town and even from store to store. The class of consumer—his income and way of living—in the trade area determines to a great extent the class of merchandise that will be offered for sale, since the merchant selects the merchandise he believes his customers will be able to buy. Thus, although the prices among several cities or towns may vary greatly, the quality of the merchandise handled, except for standard items, probably varies roughly in proportion. Since competition is far from perfect, however, some price differences exist not only among stores in different towns but among stores in the same community. Some stores, indeed, enjoy a quasi monopoly as regards location.

To summarize the discussion thus far, then, marketing is a very necessary part of the production system since the mere manufacture of goods does not make them available to those wishing to consume them. In the complete marketing process, there are certain essential tasks which must be performed. The performance of such functions is assumed by various functionaries—individuals or institutions—whose existence is justified by their ability to undertake efficiently certain portions of the marketing burden. The manufacturers choose their marketing channels on the basis of the relative effectiveness with which the job can be accomplished by various combinations of functionaries.

The consumer-buyer is part of the retail market area within which there is a market center. To this center come goods from which the consumer makes choices. Owing to a combination of factors, retail prices among various areas are very similar, though the price lines that each group of merchants features may be quite different since they depend upon the incomes and desires of particular classes of individuals.

3. Increasing Marketing Costs. From the evidence obtained currently, it would appear that marketing costs are increasing. Although the costs of marketing some commodities have perhaps declined during the past 20 years (*e.g.*, costs of staple groceries), many others have increased. For every dollar spent in the manufacture of goods, a dollar or more is spent in the marketing process, on the average, including transportation from the point of origin to destination. In general, the marketing process probably takes a greater share of the consumer's dollar than heretofore. The reasons for such a situation are worthy of some attention.

Probably the most important cause underlying increased costs of marketing is that the techniques of production (again in the narrow

sense of the term) have improved to such an extent that greater and greater quantities of goods have been produced. In other words, the manufacturing side of the system has, by means of an improved technological process, been enabled to increase production, and the resultant increased product has been turned over to the marketing system to sell. Though manufacturing is, in a manner of speaking, of a decreasing-cost nature, marketing is more a constant- or increasing-cost type. Marketing is largely without benefit of technological

TABLE 47. PERCENTAGE OF THOSE GAINFULLY EMPLOYED IN PRODUCTION, MARKETING, AND PROFESSIONAL OCCUPATIONS, 1870–1940*

Year	Production	Marketing	Professional, clerical, and domestic
1870	69.0	9.9	21.1
1880	66.1	10.8	23.1
1890	62.7	14.6	22.7
1900	60.1	16.4	23.5
1910	63.5	16.4	20.1
1920	59.7	17.6	22.7
1930	52.8	20.4	26.8
1940†	49.0	24.0	27.0

* Adapted from census data. PAUL D. CONVERSE and H. W. HUEGY, "Elements of Marketing," 2d rev. ed., p. 8.

† Preliminary figures.

aids and, hence, must carry the burden by means of the increased use of labor. Evidence supporting this increased use of man power in marketing is found in Table 47. Though in 1870 only 10 per cent of those gainfully employed were employed in marketing, by 1940 this figure had increased to 24.0 per cent. Between the same years, the percentage of those engaged in manufacturing had declined from 69 to 49 per cent.

The more goods there are to distribute, the greater the attempts to manipulate demand. The buying public is thus importuned on every hand, by newspapers, radio, magazine, and billboard, to buy more, better, or different goods. Every type of sales-promotional device imaginable has been utilized in an effort to sell more goods. At the same time, unfortunately, advertising effectiveness tends to be reduced owing to the offsetting effect of competitive campaigns and to consumer resistance which accompanies the attempt to load the consumer with more goods than he can conveniently purchase.

Another factor giving rise to increased marketing costs is the fact that goods are being carried greater distances now than heretofore. It is a well-known fact that transportation makes specialization of area possible and that specialization of area is a definite characteristic of our modern economy. Instead of a system giving rise to self-sufficient small areas, the law of comparative advantage makes for specialization and a subsequent exchange of goods. This condition gives rise to greater use of transportation facilities. Furthermore, many manufacturers are successful in differentiating their several brands of products with the result that such products are demanded by consumers regardless of their origin. Hence, while many New Englanders are purchasing shoes manufactured in the St. Louis area, the residents of the latter region may be buying shoes produced in New England. All of this gives rise to cross shipping; and, since transportation is a phase of marketing, the added cost is allocated to the marketing process.

Fashion has also had an important effect on marketing costs. In days gone by, it was possible for a retailer to purchase merchandise for 6 months ahead. This meant that it was necessary for salesmen to make, say, only two calls per year. It meant, furthermore, that shipments could be made at carload rates. Not only have rapid fashion changes caused an increase in costs of selling and transportation, but they also made it necessary for retailers to adopt expensive stock-control systems and to assume the burden of costly markdowns on merchandise that suddenly loses popularity. The tendency of fashion changes is to give rise to higher marketing costs.

There is little doubt of the existence of intense competition in the marketing field. Competition, though tending to keep prices close to the cost level, tends also to give rise to certain items of additional cost. For example, many types of stores continually feel the necessity of obtaining increased sales volume. Such institutions are faced with the choice of cutting prices, increasing advertising, or improving service. Many retailers have felt that the last course is most effective for this purpose. As a result, department and specialty stores, particularly, have vied with one another to prove the contention that the customer is always right. Free delivery (of any amount of goods to almost any point), children's playrooms, extended credits, and return of unsatisfactory merchandise are some of the items of service extended. Although these are costly, people have now become accustomed to them and consequently demand that they be continued.

One can get some notion as to the costliness of such services if he considers for the moment the cost elements entering into the return of "unsatisfactory" merchandise by a customer. One must recognize the fact that the time spent by the salesperson, though paid for, has proved completely ineffective; that the item has had to be delivered and picked up; that for sales purposes, while the item is out of the store, another has to be in stock; that the item may have become shopworn as a result of excessive handling. All this effort is completely wasted, and the cost of the waste effort is manifested in the expense percentages of individual merchandising institutions.

The competitive system also gives rise to another type of cost. There is, in many types of marketing institutions, an *optimum size*. That is to say, very small and very large concerns often have higher costs as a percentage of sales than concerns of so-called optimum size. In the retail field, particularly, are to be found thousands of high-cost enterprises most of which are of extremely small volume. Not only are these concerns inefficient in themselves, but also, because each takes a portion of the volume that would go to others, some of their more efficient competitors suffer as well.

There have been, of course, significant countertendencies at work to offset, at least partly, increasing marketing costs. Hence, " . . . chain stores have reduced the costs of retail and wholesale marketing in numerous lines; and some of the cooperative associations of farmers have succeeded in cutting marketing costs. Undoubtedly, the application of more scientific methods will result eventually in large economies in marketing."[1]

An increase in marketing costs in itself is not necessarily an indictment of the system in any case. It must be recalled that marketing is a part of production (in the broad sense of the term) and that, whereas manufacturers create form utilities, distributors create time, place, and possession utilities. It should be recalled further that, though manufacturers may call machinery into play when they decide to increase production, distributors, in general, must resort to increased man power if the increased product is to be marketed. Now if, by forcing the marketing system to assume an increased burden, the manufacturers are able to cut down their cost by a greater amount, there is a net advantage to society.

Much the same reasoning may be utilized in pondering increased transportation costs among specialized areas. Although the result

[1] "Recent Economic Changes," p. 421.

makes marketing more costly, the gains accruing to production in many instances are more than enough to offset that increase.

In some instances, specialization of person likewise makes for increased marketing costs. The farmer who used to produce most of the goods he required (such goods being charged with no marketing costs whatsoever) now often specializes in one or, at most, a few commodities and purchases his other requirements through regular marketing channels. The commodities so purchased presumably are charged with various distribution costs including that arising out of transportation.

It is not enough to state, however, that an increase in marketing costs is justified by virtue of a resulting increase in the relative efficiency of the whole production system. There is still the question as to whether there are not points of actual inefficiency in our existing marketing process. In other words, admitting that recent increases in marketing costs may be justified, are there not possibilities of offsetting such tendencies through technical and other types of improvement? The several possibilities along these lines will be explored in subsequent sections of the present chapter.

4. Wholesale and Retail Costs. Marketing costs are expressed as a percentage of sales. That is to say, if the expenses of doing business of a retailing concern are 20 per cent, this means that 20 cents out of every consumer's dollar spent in that establishment goes for costs of retailing the commodities handled by that institution, the balance going to cost of the goods sold and to profit, if any.

Tables 48, 49, and 50 show representative costs of various types of marketing institutions. From these it may be seen that frequently

TABLE 48. OPERATING EXPENSES OF SELECTED TYPES OF WHOLESALE CONCERN,* 1939†
(Per cent of sales)

Type	Wholesale expense	Type	Wholesale expense
Drugs and drug sundries (specialty lines)	26.5	Clothing and furnishings	14.4
Hardware	18.4	Drugs (general line)	13.0
Jewelry	17.6	Far products (consumer goods)	13.0
Furniture and house-furnishings	17.2	Groceries (general line)	9.5
Dry goods (general line)	15.1	Tobacco and products (except leaf)	4.9

* Service and limited-function wholesalers.
† U.S. Census, 1940: "Census of Business, 1939," vol. II, "Wholesale Trade," pp. 49–52.

50 per cent of the consumer's dollar goes to marketing. Table 48 gives figures for expenses of wholesale concerns, and Tables 49 and 50, for those of retail establishments. There are certain specific conclusions that may be drawn from these data.

1. It will be noted that wholesale costs are lower than retail costs in the same line of business despite a lower base price for the former.

TABLE 49. OPERATING EXPENSES OF SELECTED TYPES OF RETAIL BUSINESS, 1939*
(Per cent of sales)

Type of retailer	Expense	Type of retailer	Expense
Jewelry	43.6	Shoes	30.7
Radios	42.1	Confectionery	29.3
Housefurnishings	37.2	Drugs	28.1
Furniture	33.7	Hardware	26.7
Men's furnishings	33.2	Lumber and building materials	24.0
Lingerie, hosiery, millinery	32.5	Groceries	16.9

* Figures reported by H. H. Maynard and T. N. Beckman in their "Principles of Marketing," (4th ed., p. 667) from Dun & Bradstreet data.

TABLE 50. OPERATING EXPENSES, MARGINS, AND NET PROFIT OF DEPARTMENT STORES BY ANNUAL SALES VOLUME, 1946*
(Per cent of sales, in thousands)

Items	Less than 150	150–300	300–500	500–750	750–1,000	1,000–2,000	2,000–4,000	4,000–10,000	10,000–20,000	20,000–45,000	45,000–or more
Cost of goods	70.0	69.5	66.7	66.8	65.5	64.8	64.6	63.8	63.8	63.8	64.3
Gross margin	30.0	30.5	33.3	33.2	34.5	35.2	35.4	36.2	36.2	36.2	35.7
Total expense	21.2	20.5	23.3	24.9	24.5	27.1	26.0	27.5	28.8	28.8	28,0
Net profit or loss	8.8	10.0	10.0	8.3	10.0	8.1	9.4	8.7	7.4	7.4	7.7

* MALCOLM P. MCNAIR, "Operating Results of Department and Specialty Stores in 1946," *Harvard Univ. Graduate School of Business Administration Bull.* No. 126, p. 12.

The main reasons for this condition are that wholesaling institutions ordinarily are able to do a larger volume of business per employee owing to larger orders, less personal service, etc.; that locations required by wholesale institutions are of the less expensive type; and that space can be more intensively utilized in the wholesale phase of marketing operations.

2. The retail marketing of convenience items, particularly staple foodstuffs, is much less costly than the handling of shopping items, a condition that arises partly out of lower priced locations, partly out

of a more effective use of space, and partly out of more intensive utilization of selling time.

3. From the data in Table 50 one may infer that operating costs vary with volume of sales. Some data suggest the existence of an optimum size, *i.e.*, a size at which expenses are at a minimum. This

TABLE 51. OPERATING EXPENSES, GROSS MARGINS, AND NET PROFIT OF DEPARTMENT STORES, 1935–1946*
(Per cent of sales)

Item	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946
Gross margin	35.9	36.5	36.4	36.4	36.9	36.95	38.2	38.7	38.4	37.9	37.6	35.9
Expenses	34.9	33.9	35.0	36.4	35.4	34.75	33.4	31.2	28.7	27.4	27.85	28.1
Net profit or loss	1.0	2.6	1.4	0.0	1.5	2.2	4.8	7.5	9.7	10.5	9.75	7.8

* MALCOLM P. MCNAIR, "Operating Results of Department and Specialty Stores in 1946," *Harvard Univ. Graduate School of Business Administration, Bull.* 126, p. 3.

seems to have been true in the grocery field until comparatively recently,[1] as indicated by the following sales and expense data adapted from Harvard Bureau of Business Research figures for an earlier year:[2]

Sales Volume	Expense, per cent
Under 30,000	19.9
30,000– 49,999	17.9
50,000– 99,000	17.5
100,000–149,000	18.0
150,000–249,000	18.2

[1] It is interesting to note that expenses vary greatly, as a per cent of sales, among various *items* carried in a retail store. A study of costs of handling different merchandise items was made by the U.S. Dept. of Commerce in Louisville, Ky., some years ago and the following figures were derived from it:*

Commodity line	Expense, per cent	Commodity line	Expense, per cent
Beverages	37.4	Meats	17.8
Candy and gum	33.2	Fresh fruits and vegetables	17.0
Canned food	26.2	Salad dressing	16.1
Cereals	23.5	Cheese	13.6
Dried fruits and nuts	20.0	Coffee	9.6
Bakery products	18.7	Flour	9.2
Tobacco	18.4	Ice cream	7.6
Milk	18.0	Butter	7.0

* Adapted from Department of Commerce figures appearing in P. D. Converse and H. W. Huegy, "Elements of Marketing," 3d rev. ed., p. 531.

[2] These figures apply to a period before the coming of the supermarket. The

That it does not work out in the same fashion in all instances can be seen from other data. In department stores, for example, expense percentages seem to be rather consistently higher in the large stores than in the small or medium-sized establishments (Table 50). It should be noted, however, that a volume increase over that normally experienced exerts a downward pressure on expense percentages. This is shown in Table 51 and explains the extraordinary profitability of department stores and many other retail stores during the Second World War.

This introduces a question of prime importance in this connection. Can operating expenses be accepted as an adequate index of merchandising efficiency? This question has been given little consideration by the economist but is, according to the view of the authors, of prime significance from the social standpoint. Let us assume a hypothetical example designed to compare the operating results of two imaginary establishments *X* and *Y*. The former, let us say, is the smaller store, the latter the larger. Under the assumed situation, *Y*'s expenses in terms of percentage of sales are higher than those of *X*. The assumed cost-of-goods-sold figure, however, is greater in the case of *X* than in that of *Y*. The results are as follows:

Store *X*		Store *Y*	
Sales	$100	Sales	$100
Cost of goods sold	73	Cost of goods sold	70
Gross margin	27	Gross margin	30
Expenses	28	Expenses	29
Net loss	1	Net profit	1

In this hypothetical case, store *X*, whose expenses percentage is definitely lower than that of *Y*, had a net loss of 1 per cent, whereas *Y* (despite greater expenses) earned a net profit of 1 per cent. This condition is obviously due to some sort of purchasing advantage that is enjoyed by store *Y*. Although the foregoing is only a hypothetical example, the actual figures given in Table 50 seem to bear out the theory to some extent.

self-serve, mass selling food-dispensing establishment seems to have overcome this tendency toward optimum cost in the medium-volume establishments. Can the student suggest the reasons for this?

The specific reasons for a situation of this kind are worthy of some attention. In the first place, the larger store buys in larger quantities and hence earns greater discounts. This, in turn, is due in part to the use of group and central merchandising techniques and in part to effective aid given the manufacturer by the large retail distributor. In the second place, the buying talent is more efficient owing to the fact that larger stores are able to draw the best men and to practice specialization of effort. Indeed, many chain buying specialists become more expert in production techniques than the industrial manufacturers themselves.

The advantage accruing to larger establishemnts by virtue of this apparently anomalous cost situation is of social as well as individual significance. It would be advantageous to the consumer, in other words, if the savings coming about as a result of higher but more intelligent expenditures were shared with the consumer in the form of lower prices. Indeed, this condition frequently occurs. The possibility of this occurrence is easily appreciated when it is recalled once again that the consumer's dollar is divided into three parts going respectively to cost of goods, operating costs, and net profits. If, by spending a larger proportion of the consumer's dollar for operating expenses, the management is able to increase its volume and therefore buy more advantageously, an increase in net profits and a decrease in consumer's prices may occur coincidentally. It is, of course, possible that a shrewd buyer in a small establishment may be quite as efficient as his competitor in the larger, but such a situation is not typical. The latter with his triple advantage of an ability to find the best "buys," earn larger quantity discounts, and buy to price lines with less likelihood of markdowns is frequently able to offer the consumer better values despite higher operating expenses.

5. Integration in Marketing. In an important sense, our marketing system is in a constant state of flux. Better methods, though perhaps slower in developing than technological changes in industry, are constantly appearing. Such changes usually take the form of new methods designed to carry the functional burden in a more efficient way. Often the resulting increase in efficiency is advantageous socially as well as individually, though this is not necessarily so. Indeed, at times the basic reason for "improved" methods is that of controlling the product all the way through the marketing process for the specific purpose of "price stabilization."

Though the wholesaler actually performs important marketing

services,[1] the tendency in recent years has been toward integration or vertical combination—*i.e.*, combining wholesaling, retailing, and in some instances even manufacturing under one management. Hence, such integrated institutions as department stores, chain stores, and, in some localities, supermarkets, have become increasingly important in the distribution picture. Table 52 shows the importance of chain distribution in our marketing system for the years 1929 and 1939. Thus one is enabled to draw some inferences regarding chain growth in particular fields as well as to make comparisons with respect to the success of chain merchandising as among fields. As can be seen from the figures, though less than 22 per cent of the *total* retail business in 1939 was done by chain establishments, almost 87 per cent of the variety business was carried by chain enterprises. Grocery chains having well under 40 per cent of total grocery business in the United States in 1939 have managed to make much greater strides in certain localities than others. It is quite evident from the figures, moreover, that chain methods seem not to lend themselves to certain commodity fields at all. Table 53 indicates that chains seem to be more successful in certain regions than in others.

Let us inquire somewhat specifically into the reasons for chain-store development.[2] Probably the most important basic reasons for their success are: (1) a more efficient merchandising system, (2) lower buying prices due to volume, and (3) the success of the practice of shifting some of the marketing functions onto the shoulders of consumers.

Recent inquiries by the Federal Trade Commission have revealed that special discounts—trade, cash, advertising allowances, etc.—have frequently been made to chain organizations by manufacturers. These discounts, though small in relation to the amount of business done,[3] have in many instances amounted to more than the decrease

[1] For example: bringing together products at convenient points so they can be supplied on short notice, offering credit, advising both manufacturer and retailer as to items most in demand, storing commodities not required at the moment, taking the selling burden from the shoulders of the manufacturer, etc.

[2] They have not gained their advantage, as some uninformed critics would have it, through short-weighting and shortchanging customers. See FTC Chain Store Inquiry Doc. No. 153, entitled "Short Weighing and Overweighing in Chain and Independent Stores."

[3] Safeway, for example, obtained allowances amounting to $1,663,670 in 1934, which was only 0.68 per cent in terms of their sales of $243,000,000 that year; this ⅔ of 1 per cent certainly does not account for the bulk of difference between chain and independent prices as chain-store critics seem to think. See RALPH CASSADY, JR., The Chain-Independent Controversy, *J. Marketing*, July, 1942, p. 59.

TABLE 52. PROPORTION OF THE TOTAL RETAIL BUSINESS DONE BY CHAIN STORES IN EACH OF 31 MERCHANDISE FIELDS AND IN ALL FIELDS COMBINED, 1929 AND 1939*

Merchandise fields	1929	1939
Variety stores	90.1	86.8
Shoe stores (all kinds)	38.0	49.7
Accessory, tire, battery dealers	....	45.1
Dairy products, milk dealers	....	41.4
Combination stores (groceries–meats)	32.2	38.4
Grocery stores (without fresh meats)	45.7	32.4
Department stores	16.7	30.0
Newsdealers	....	27.3
Women's ready-to-wear stores	22.7	26.1
Cigar stores, cigar stands	25.1	27.1
Drugstores, with fountain	....	27.1
Paint, glass, wallpaper stores	....	26.6
Men's–boys' clothing, furnishings, hat stores	21.2	22.2
Drugstores, other	....	20.6
Lumber, building materials dealers	....	20.0
Household appliance dealers	....	18.3
Family clothing stores	27.3	17.8
Candy, nut, confectionery stores	....	17.3
Fuel, ice, fuel-oil dealers	18.3	15.1
Furniture stores	14.2	14.6
Restaurants, other eating places	13.6	13.9
Hay, grain, and feed stores	....	11.9
Jewelry stores	6.4	10.5
Filling stations	33.8	10.2
Radio–household-appliance dealers	....	10.2
Radio stores, other	19.1	19.1
Farm and garden supply stores	....	8.1
Hardware stores	3.0	4.0
Liquor stores, packaged goods	....	3.4
Florists	....	3.1
Motor-vehicle dealers (new)	....	2.7
All fields combined	20.3	21.7

* U.S. Census, 1940: "Census of Business, 1939," "Retail Trades," Types of Operation, pp. 5–6.

in marketing and manufacturing costs arising out of large-order business. Such discounts of course have been of definite advantage to chain establishments in the past but are now controlled by the operation of the Robinson-Patman Act, which circumscribes the buying and selling relationships of the retailers and manufacturers by making discriminatory discounts (those exceeding actual savings

in marketing and manufacturing costs) unlawful.[1] Legitimate savings arising out of volume purchases may still be extended to large buyers by the sellers, however, and properly so.

As was previously stated, the chains have also been successful in their attempt to induce the consumer to assume certain of the marketing functions that had hitherto been carried by the retail establishment. Thus in many types of retail enterprises service

TABLE 53. THE PROPORTION OF TOTAL RETAIL BUSINESS DONE BY CHAINS, BY GEOGRAPHICAL DIVISIONS AND FOR THE UNITED STATES AS A WHOLE, 1939*

Geographical area	Per cent of total sales by chains, 1935
New England states (Maine, N.H., Vt., Mass., R.I., Conn.)	24.1
Middle Atlantic states (N.Y., N.J., Pa.)	23.3
East North Central states (Ohio, Ind., Ill., Mich., Wis.)	25.6
West North Central states (Minn., Iowa, Mo., N.Dak., S.Dak., Nebr., Kans.)	20.0
South Atlantic states (Del., Md., D.C., Va., W.Va., N.C., S.C., Ga., Fla.)	21.3
East South Central states (Ky., Tenn., Ala., Miss.)	17.6
West South Central states (Ark., La., Okla., Tex.)	19.9
Mountain states (Mont., Idaho, Wyo., Colo., N.M., Ariz., Utah, Nev.)	19.7
Pacific states (Wash., Oreg., Calif.)	23.7
United States total	21.7

* U.S. Census, 1940: "Census of Business, 1939," "Retail Trade, Types of Operation, p. 7.

is conspicuous by its absence. Although the cost of carrying credit accounts and delivering merchandise has not been so great as is often assumed, still there have been actual savings to be derived which could be passed on to the consumer in the form of lower prices.

The most important advantage of chain operation, however, lies in its greater operating efficiency. One of the typical organization fundamentals in chain-store operation is the separation of planning and doing. That is to say, the central management specializes in

[1] The act, in brief, amends Sec. 2 of the Clayton Act and makes it more specific. Hence, under the law (1) variations in prices to different buyers must bear a *determinable* relationship to variations in sellers' costs and (2) services extended various buyers must not be discriminatory but must be furnished all buyers on "proportionally equal terms." Generally speaking, the law proscribes price discrimination among various buyers of goods of like quantity and quality if the result is that of injuring a competitor and interstate commerce is involved.

the planning of all major activities, and the decentralized workers specialize in the execution of the plans. In chain operation, selection of personnel is given careful attention in order that plans may be efficiently carried through. The question of selection of location on a scientific basis is studied, since the attainment of an establishment of optimum size leads in many merchandising fields to a condition of lowest cost. Chain management, therefore, selects locations according to population concentration in order to ensure the attainment of an effective sales volume. The layout of chain units also has been scientifically studied in order to allow the handling of a large volume per salesperson. The same situation obtains in buying—specialists are consistently on the lookout for better ways of doing things which will result in savings. Moreover, some of the costly effort necessary under orthodox methods, such as sales-purchasing activity between the wholesaler and retailer, becomes unnecessary under an integrated system.

Although the grocery field cannot be considered as completely typical of all chain operation, it is illustrative of chain principles. In a study of grocery retailing made by Prof. Roland S. Vaile of the University of Minnesota, it was revealed that the difference in efficiency between the independent wholesaler and retailer setup and that of the chains as indicated by expense figures was very marked.[1] The main differences were in pay roll, interest expense, and trucking costs, although there were also minor differences in the items of taxes and supplies. By far the most important point of difference was in pay-roll expense. This can be explained in two ways: (1) by an actual difference in salaries and wages paid chain employees (made possible by the assumption on the part of chain employees that they receive a psychic income in the form of a chance for advancement); and (2) by a difference in terms of percentage of sales due to a greater sales volume per salesperson. The latter is due in turn, for the most part, to better locations and more effective store layout. The difference in interest and taxes is probably due to a more effective stock policy based upon scientific selection of wanted items and simplification of the stock structure. That is to say, chains have a policy of selecting only a limited number of brands on which to concentrate their sales effort, thus making possible carrying on operations with a relatively small stock. The effect of this policy, incidentally, is that of shifting part of the marketing burden to full-line independents.

[1] "Grocery Retailing," p. 46.

Thus, chains direct their attention toward the control of distribution costs and, at the same time, toward the purchase of their merchandise requirements at the lowest possible cost. To the extent that they are successful in this two-point program they have an advantage in the market place.

How much of the increased efficiency arising out of chain operations is passed on to the consumer has not been clearly demonstrated. According to studies that have been made, there are important

TABLE 54. INDEX OF PRICES: CHAINS VS. INDEPENDENTS
(Chains – 100)

Type of item	Chains	Independents
Groceries*	100.0	108.5
Drugs*§	100.0	120.7
Piece goods and furnishings†‡	100.0	119.6
Auto Accessories†‡	100.0	132.0

* FTC figures reported by C. F. Phillips, *J. Marketing*, January, 1938, p. 191.
† T. N. BECKMAN and H. C. NOLEN, "The Chain Store Problem," pp. 131–135.
‡ Larger chains.
§ The difference in drugs is now much less than this in most states, due to Fair Trade legislation

differences between chain and independent prices. Studies made by economists and by government agencies in various localities indicate differences of between 5 and 14 per cent in groceries; a somewhat greater amount in drugs. Figures for these and other commodities are given in Table 54, although it should be kept in mind that differences in prices between individual establishments may be greater or smaller than the averages. Many of these studies, however, were based on a group of specific branded items common to the several stores under investigation, and one wonders whether the so-called *representative* items were actually representative. In the grocery field, where privately branded and nonbranded items are not taken into account at all, one cannot but doubt the validity of the measuring device. Regardless of the limitations of the measuring techniques utilized in price studies, some difference between chain and independent prices undoubtedly exists, although the exact difference is imponderable. Indeed, a measurement of price differences existing at the moment is not of great social importance in any case, since the level of efficiency has already improved materially as a result of chain competition. In other words, one cannot measure the social effectiveness of chain operations by a mere measurement of price

differentials at the present time, since chain competition undoubtedly has increased the level of efficiency in the industry as a whole and thus has had a depressing effect upon the level of prices of the independents. Though efficiency differentials are somewhat narrower than they once were, the beneficent effect of chain competition should not be underestimated.

The tremendous growth of chain stores has given rise to legislation designed to curb their activities. This activity has taken at least four forms: state tax laws, resale price maintenance laws, Unfair Practice acts, and antidiscrimination legislation. Where states have placed a discriminating tax burden upon chain operations, the main purpose is to reduce operating efficiency differentials between chain and independent establishments. Such legislation is, to say the least, reactionary and actually penalizes efficiency. It would be much better if, instead of lowering the level of efficiency of the low-cost institutions, someone would attempt to devise a method of raising the level of efficiency of the high-cost firms.

Legislation making legal the maintenance of resale prices by manufacturers is now in effect in 45 of the 48 states. Although this subject is discussed in detail in another chapter (Chap. XVI), it is important in this connection to understand that it makes unlawful the sale of merchandise at prices lower than those named by the manufacturer, the effect being that of eliminating retail-price differentials between independents and chains. In other words, the efforts of the chains to pass efficiency savings on to the consumer are definitely circumscribed as a result of price-maintenance legislation.

The Robinson-Patman legislation is perhaps more justifiable economically. It is designed, ostensibly at least, to eliminate unfair buying advantages possessed by the chain institutions. Possibly one could not justify chain buying advantages arising out of the exertion of quasi-monopolistic power in demanding price concessions. Such advantages may be unsound economically under a system depending on competition to bring about economic efficiency. If, however, advantages accuring as a result of production savings are made unlawful, the result is that of freezing an existing situation, thus penalizing economic progress. The danger of such legislation lies in the possibility of the failure of its administrators (the FTC) completely to recognize efficiency savings. If such a situation eventuates, the level of efficiency will be forced downward and inefficiency will be perpetuated.

6. Critical Evaluation of the Marketing System. The marketing system in the United States is a product of a competitive economic system. Undoubtedly many phases of it are economically ineffective. There is, in other words, opportunity for improvement in the economic efficiency of the existing system of market distribution.[1]

Though marketing under a completely regimented society would have to bear the functional burden, there is little question but that such a system (everything else remaining equal) would result in reduced marketing costs. Consider for a moment the increase in technical efficiency that would arise if the consumer were instructed to appear at a certain specific time at a specified place to receive goods which had been selected for him by some governmental agency. Such a system would eliminate freedom of selection with its attendant factors: incompletely utilized store facilities and idle clerical time.

Aside from the fact that such a system would be unbearable and unacceptable to the population of a country whose institutions have been based upon a relative freedom of economic activity, a limitation appears that might well affect the apparent economic advantage suggested above. As has been suggested in another chapter, savings may accrue in a static situation that would be more than offset by an absence of improvements that ordinarily arise out of a dynamic situation. That is to say, a regimented society practically eliminates competition and, though competition is wasteful in some ways, there is no gainsaying the progress (measured in terms of improvements in techniques) that is made under it. The history of the automobile is suggestive in this connection. If Henry Ford had had a monopoly of car building, it is quite possible that we would still be riding around in Model T's. Competition has forced progress in the refrigeration field, in the railroad industry, and in many another. Monopoly seems to be reactionary, seems to make for complacency. Competition either of the intra- or interindustry type brings about improvement. Though its effects are not immediate, competition is a force the results of whose continual operation become manifest in time.

Existing methods of marketing are continually tending toward change. Integration offers many possibilities for improved economic

[1] According to the Committee on Distribution of the Twentieth Century Fund, "There are three general areas where the problem of distribution costs should be attacked: First, consumer knowledge; Second, efficient performance; Third, legislative restrictions and regulations." For a full discussion of these see P. F. Stewart and J. F. Dewhurst, "Does Distribution Cost Too Much?" pp. 349–367.

efficiency. The department store is an integrated type of concern, combining wholesaling and retailing functions. The chain is another. The newly established supermarket, combining as it does all types of food marketing under one roof, holds many possibilities. The average expenses of such institutions are lower than those of small single-unit establishments. For example, many of the grocery departments of the larger supermarkets are able to do business, at present, at an expense rate of from 10 to 12 per cent in contrast to a rate of 16 to 20 per cent for smaller service institutions. From a social viewpoint part of this advantage is more apparent than real, for at times either (1) the grocery department is operated on a "loss-leader" basis, the difference being made up in other departments, or (2) the supermarket owner who is also operator of the grocery department leases other departments at figures which allow him to charge himself only a small amount for rent. A substantial part of the cost differential, however, undoubtedly is real. In some sections of the country, the small independent cannot continue to exist in competition with this new type of retail concern. Thus, in time, better methods increase the efficiency of the whole system by forcing competitors to improve their techniques or to withdraw from the field.

But regulation is probably necessary also. Unfair marketing practices, such as false advertising, fraudulent failures, and commercial bribery, are socially costly since by such practices uneconomic units are perpetuated. The racket whose underlying philosophy is to create a hazard against which, for a fee, it "protects" the businessman is also exceedingly costly since the prices of commodities are affected by such activities.

Regulation has even been suggested to limit by license the number of retail outlets in each field. Retail failures in some lines run as high as 50 per cent the first year and are, to a great extent, due to incompetence.[1] That there is a tremendous amount of waste

[1] A study of grocery retailing in the Twin Cities (Vaile, *Grocery Retailing*, p. 42) showed the following with respect to the experience of new Minneapolis independent proprietors in that field:

Length of Grocery Experience	Percentage of Total Returns
None	51.69
Retail:	
Under 3 years	8.99
3 to 5 years	12.36
Over 5 years	19.10
Wholesale	4.49
No answers	3.37

involved in failures there can be little question. Whether licensing prospective entrants on a basis of experience is advisable, however, is doubtful.

There is much room for research in the field of marketing. Further research effort along the lines of less costly methods of marketing should be undertaken. Though much has been accomplished by government agencies such as the United States Department of Commerce, most of this effort has been expended to aid individual business firms. Although such research activity is of undoubted value, a program of research undertaken from the social point of view would be much more worth while to the consumer. Many problems suggest themselves. There is, for example, room for further studies on simplification, shipping methods, and differences in cost accompanying variations in size of individual orders, in sales volume, and types of institutions.

There are also some possibilities of controlling costs through consumer education. It is a well-known fact that certain types of retail institutions are going too far with their slogan, "The customer is always right." The volume of returned merchandise in some retail establishments, for example, amounts to 20 per cent of net sales. The consumer should be made to understand that a condition of this type can result only in increased costs of doing business and is probably reflected in higher retail prices. There is in addition evidence leading to the conclusion that small consumer purchases are very costly; that larger average orders can be handled at lower costs. Such information should also be made available to the consumer, perhaps by joint effort on the part of retail institutions. Consumer ignorance and thoughtlessness very probably lead to considerable marketing waste.

However, when all is said and done it must be remembered that ours is an economic society based on freedom of choice and that under such a system "wastes" are bound to prevail. Thus, to some extent at least, costs are high because in hundreds of thousands of stores at this moment clerks are waiting for customers who may not appear until tomorrow, next week, or next month, but who expect to be served when they do appear. But while this system involves seeming wastes, these are offset by many advantages including the stimulating effect of competition and the freedom of action which the system implies. In short, though in a sense it is somewhat wasteful, we feel that this system allows for the greatest amount of satisfaction in long-run terms.

Questions

1. When will a saving in marketing costs be passed on to consumers in the form of lower prices and when retained by the organizations making the saving?

2. Are chain stores bad for a community? What criteria should be utilized in making a decision about this matter?

3. Chains have been accused of cheating their customers by under-weighing and shortchanging tactics. The Federal Trade Commission made a study of this some years ago and the results are published in their *Chain Store Inquiry*, (72nd Congress, Second Session, Document No. 153). Study these figures and report briefly on your findings.

4. The authors have pointed out that the main chain store advantage in efficiency lies in the operating phase of the business rather than in the buying phase. This conclusion was based on the assumption that we were considering the marketing of standard brand merchandise. Would this same conclusion apply to the handling of privately labeled merchandise lines? Explain.

5. Are marketing costs higher now than, say, 50 years ago? If so, does the fault lie in marketing inefficiency? How far is the present trend toward an increased proportion of the gainfully employed in distribution likely to go?

6. Small retailers frequently remain in business for only a short time before failing. Does this increase the cost of goods to the consumer?

7. Prepare a paper on the limits which seem to exist to chain-store expansion in the United States.

8. Distinguish clearly between the terms *buying habits* and *patronage habits*. Explain their significance in the field of consumer economics.

9. "The way to cut down distribution costs is to eliminate half the middlemen." Is this so? Why or why not?

10. How will the development of the frozen-food industry affect marketing costs in the food field? How about dehydration?

11. During the inflation following the Second World War there have been organized in various cities meat-of-the-week clubs which, for a membership fee of $1.25 per week say, the member is allowed to buy his meat requirements at slightly more than wholesale price. The principle of the scheme purportedly is that the butcher is to receive a fee for his services and for expenses and that this allows the merchandise to be sold without the usual retail margin. Discuss this principle critically.

CHAPTER XV

RETAIL PRICES OF CONSUMERS' GOODS

Price in the competitive economy is the regulator of production and consumption. That is to say, the amount of any commodity offered by producers will, in the long run, be governed by prices and their relation to cost. Likewise, the amount of the commodity taken by consumers will be governed to a considerable degree by the price of the commodity offered. Hence, price has the twofold purpose of determining the amount of goods that will come onto the market and the amount that will be drawn off.

Perhaps the most familiar price phenomenon, to students of economics, is that of the normal price analysis. Normal price, it will be recalled, is "the price that would prevail if only the more permanent forces affecting price-making were operative and if sufficient time were allowed to permit these forces to bring about a completely stable equilibrium of demand and supply."[1] It will be noted that the definition clearly states that normal price is that price that *would* prevail *if* completely stable equilibrium conditions obtained. Under such conditions, price would be identical with the cost of production of the marginal producer. Differentials naturally accrue to the more efficient enterprisers; losses to the submarginal concerns. The latter, of course, would be expected in time to disappear from the competitive picture although at any one moment of time there might be concerns operating at or below the margin.

The student of consumer problems is interested in *market* prices. Market price, unlike normal price, is an extremely realistic phenomenon. Though normal price is one that *would* result were demand-and-supply conditions allowed to work themselves out, market price is an actually existing price. Market price, in other words, is the price that actually exists in the market place at any one moment of time, the price at which a commodity is actually sold. The analysis of market price takes into account only short-run factors, the actual supply-and-demand conditions obtaining at the moment. Cost of production, for example, is an unimportant factor in the market-price

[1] F. B. Garver and A. H. Hansen, "Principles of Economics," rev. ed., p. 97.

analysis, since in the short run immediate adjustments in long-run supply factors (shifting capital, etc.) cannot be made. Cost of production, therefore, for all practical purposes is of minor significance as a price factor in the short run. One has only to recall the many instances of producers or distributors selling their product for "whatever they can get" to grant the truth of this assertion. Picture, if you can, a vendor attempting to convince a buyer that the latter should pay $1 for a certain commodity on the ground that this was its cost of production, when because of a glut in the market a similar article can be purchased from other vendors for 50 cents. While one must insist that the cost of production is of relatively little aid in analyzing market prices, one must be equally insistent that it is one of the major determinants of normal price. Moreover, normal price is that price toward which the market price tends in the long run.

If a perfect market existed,[1] there would be only one market price at a given moment of time. If, in addition, all commodities were nondifferentiated (as wheat is), no element of monopoly would exist in market prices. Markets are not perfect, however; goods, in many instances, are differentiated. Hence price differences exist, many of which result from quasi-monopolistic conditions. Thus *X* product, though actually identical with *Z* product (except for the container, perhaps), is offered at a higher price than is *Z*; or retailer *A* is able to sell *Z* brand, say, for several cents more than his competitor since he enjoys the advantage of a superior location. Prices under nonperfect competitive conditions are administered—*i.e.*, *set*—by the seller (or buyer) in accordance with some policy which he feels will be profitable considering his competitive position in the field.

1. Producer, Wholesale, and Retail Price Relationships. Under competitive conditions, there seems to be a more or less definite relationship between producer and wholesale and retail price movements. Although there are exceptions, we usually expect that changes in producers' prices will lead wholesale price changes and wholesale will lead retail. The reason for this condition is twofold. To begin with, fundamental changes in supply conditions take place not in the retailers' and wholesalers' but in the producers' markets. That is to say, changes in the supply of wool or wheat or tin take place in the raw-materials markets, and any change in price resulting from such shifts

[1] Many individuals acting independently on both the selling and the buying sides, equal information to buyers and sellers alike, homogeneous products sold by all traders, and equal ability to trade at the most advantageous moment.

first takes place in these markets. The supply situation in the retail market, on the other hand (except in relatively rare cases of temporary isolation due to floods, say), is adjusted by the simple expedient of ordering additional quantities from suppliers. Hence price changes coming about as a result of changes in supply conditions usually take place in the producers' markets first, then filter through to the retailers' markets. In some instances, indeed, the retailer elects (or is forced) to absorb part or all of any such change. Consequently retail prices fluctuate less violently than do those of the producer and the wholesaler.

Price changes taking place as a result of a change in demand conditions (except in cases where goods are physically or economically highly depreciable) usually occur first in the producers' markets, likewise. The change in demand, however, is felt first in the retail market. That is to say, an increase in consumer demand will be manifested in the form of a more active retail trade. As a consequence, the retailer increases the size of his orders. Suppliers thus keenly feel this concentration of buying orders and, in turn, place a larger volume of orders with the producers. The producers, therefore, are the ones who receive the full impact of the change in demand. Consequently, changes in prices coming about as a result of changes in demand take place first in the producers' markets, too, despite the fact that the actual change in demand was manifested first in the retail market.

Again, as in the supply-change situation, the retailers, upon receiving notice of producers' or distributors' price changes, may or may not pass on such changes to the consumer depending upon the circumstances. In the case of an increase, the retailer may find it *impossible* to pass the advance on. In the case of a price decline, on the other hand, he may find it unnecessary to share the saving.

2. The Nature of Retail Competition.[1] As was pointed out in an earlier chapter, the essence of competition is rivalry. Retail competition, in a sense complementary to that among manufacturers, has to do with rivalry among retailers for the business of consumer-buyers. Retail competition may be characterized as follows:

1. Small numbers of sellers usually are found in each line in each market, with the result that the efforts of each may have a material effect on the business of others. In consequence, competitors tend

[1] For stimulating discussions of the nature of retail competition, see E. T. Grether, "Price Control under Fair Trade Legislation," pp. 225–234 and 332–334; see also H. Smith, "Retail Distribution—A Critical Analysis," particularly Chap. IV.

to be foresighted in their pricing activities,[1] although this tendency is offset to a considerable extent in some lines by the existence of indirect competition.

2. Product-services offered are nonhomogeneous, with the result that no one product-service is likely to be completely interchangeable with another; thus, each seller is able to retain a little custom even if his prices are high, and some few may be able to retain a great deal even with prices considerably above those of their rivals.

3. Adequate information on the offerings of various retail sellers and on the demand of consumer-buyers is often lacking, although the availability of information varies greatly among different trades.[2]

4. Entrance into the retail field is easy, with the result that new, more aggressive competitors may come in at any time; in any case, freedom of entry has a tendency to limit profits.

From the foregoing it should be clear that retailing is a good example of nonperfect competition. Indeed, retailing is a complex form of a specific type of nonperfect competition; *i.e.*, monopolistic competition. Product-services offered by each seller are not homogeneous, but differentiated, each seller having some adherents to his price and other policies. Thus retailers' product-services may be differentiated on the basis of location, quality of service, personality of salespeople, dependability of merchandise handled, and what not.

It should not be concluded from the foregoing that the retail field is noncompetitive. Indeed, in certain lines (staple groceries, among others), due largely to the aggressive attitude of mass-selling institutions, combined with the fact that consumer-buyers generally are price-conscious, it is highly competitive. The foregoing analysis suggests only that retail competition is not perfect and that, as a consequence, retail prices are established by vendors; thus, prices charged by one firm may be considerably higher than those charged by another carrying the same merchandise lines.

Retail rivalry is not only of the direct type—as between two independent retail druggists located a block apart in a trading district of a

[1] In a duopolistic situation (where there are two sellers), theoretically each will be careful not to disturb the existing price situation, since the adverse effect on the competing seller may bring reprisals. However, this tendency is vitiated to some degree in the retail field by the complexity of the stock structure of each merchant and the resulting inability and lack of necessity to meet every move of a rival.

[2] In the grocery field, for example, information on the offerings of mass distributors usually is available to consumers, a fact which has a tendency to intensify competition.

large city, say—but, as was suggested above, indirect as well. Indirect competition may take either one of two forms:

1. It may come from a generically similar but technically different type of institution, as when a chain supermarket or mail-order house competes with a regular store (the intensity of the rivalry varying to some extent, perhaps, depending on whether the competing institution is near by or located at a distance).

2. It may come from institutions generically dissimilar but which carry certain items competing directly (as in the case of a chain variety store selling dentifrices, shaving supplies, etc., in competition with drugstores, and tools and garden supplies in competition with hardware stores).

In addition to all this there is *potential* competition, which is particularly prevalent in the retail trade because of ease of entrance. Potential competition may take the form of (a) the opening of new outlets, or (b) the extension of their influence by outlets at a distance through the use of advertising, delivery service, etc.

The intensity of retail competition has increased during the past 50 years for a number of reasons. (1) Newer types of institutions (such as chain-store companies) with their more aggressive attitudes bring exterior competition into local markets,[1] and (2) the increasing mobility of consumers makes it possible to travel greater distances to compare offerings and make purchases. This increase in intensity of competition, despite its nonperfect nature, has been instrumental in causing independent retailers to clamor for and obtain, in substantial measure, legislative devices designed to reduce the effectiveness of competition. Thus the Fair Trade laws, making legal the maintenance of retail prices by manufacturers, and Unfair Sales acts proscribing selling below cost with the intent to injure competition (discussed later) have been designed to offset the increasing intensity of retail competition which has developed over the years.

[1] Says one authority: "Department stores and mail order houses, as the typical newer large-scale retail types of the last generation, widen the areas of competitive influences tremendously, thus intruding exterior influences into local price structures. By the '90's, small retailers were up in arms against these intruders because they were allegedly, from the point of view of these dealers, supporting competition, destroying small merchants, and creating conditions under which prices to consumers would be higher. It is recognized now, of course, that these newer types on the whole introduced healthy competitive influences into the business of retailing. Their expansion was assisted by cheap and uniform postal rates, the improvement of advertising techniques and of other forms of communication, and the increased efficiency of rail transportation." Grether, *op. cit.*, p. 229.

3. Factors Affecting Retail Prices. Though it is true in some instances that retail prices are set by the producer,[1] more often prices in the retail markets are set by the retailer himself. In setting his prices, the retailer finds himself beset by many considerations. Usually the retailer sets a reservation price which he hopes will be effective in moving his stocks. Intelligent pricing transcends the use of a system of automatic markups. Though cost is taken into account, many other important elements are given consideration also. These factors are worthy of the attention of the student of consumption economics.

1. Competition is a tremendously important factor in retail pricing. Particularly is this true in the retailing of so-called *shopping merchandise.* As we shall see later, although there may be price differentials in identical merchandise as among stores in the same market area, such differentials unless justified on some basis, such as superior location, store reputation, or additional service, cannot long exist. The tendency of competition is to force retail prices down to the cost level of the more efficient enterprisers. The more effective the competition, the less chance of making unusual gains.

2. Merchandise cost (invoice cost of merchandise plus the average cost of doing business) may be used as a guide to pricing, as has been indicated. At most, however, merchandise cost can be used only as a guide. Some types of commodities never return a price that covers cost plus average expenses. Sugar is said to exemplify such a product. Moreover, since expense percentages differ from store to store, the more efficient type of enterprise often will dictate prices. Indeed, some stores price merchandise at *less than invoice cost* for the purpose of advertising. Hence, the inefficient enterprise often finds it impossible to price merchandise on a cost-plus-expense basis. The cost factor, therefore, should not be given too much weight in an analysis of the factors entering into retail pricing.

3. The type of merchandising establishment and its method of doing business are of no little importance in the setting of retail prices. As has been suggested, some types of retail concern confine their efforts to the sale of high-quality fashion merchandise. Such establishments provide elaborate fixtures and furnish complete service. Their prices are often higher than average (for the same quality of merchandise), mainly because they enjoy a quasi-monopolistic advantage in the market. Others are less sumptuous, have very plain fix-

[1] See discussion of resale-price maintenance in the following chapter.

tures, and furnish practically no service.[1] Such stores are geared to mass merchandising and, therefore, appeal on the basis of price. Their aim is usually to sell merchandise at less "than market" and depend on volume for profits.

4. The type and desirability of the merchandise offered is also an important factor. For example, when a particular line of merchandise is extremely popular (and particularly when competitors have been somewhat slow in stocking such goods), a store may be able to earn a wider margin than would be possible otherwise. Conversely, if goods that promised to be popular have been purchased in large quantities and the expected popularity does not materialize, there is nothing to do but sell the goods at a lower than average markup.[2] Merchandise subject to rapid fashion changes is usually priced at a point designed to take care of markdowns since a decline in popularity makes necessary a sharp revision in the prices of any such merchandise left in stock.

Incidentally, the amount that can be sold at a price has to be taken into account in retail pricing also. Thus, although a certain lot of 1,000 units of merchandise might be very desirable at a price of $1.00, 5,000 units would be a drug on the market unless offered for, say, 50 cents. Elasticity of demand, then (in the broad sense of the term), is a factor to be considered in retail pricing.

5. Quasi-monopolistic control of the market by the producer of a favored article has now attained a high degree of importance as a factor in retail pricing. Even in the absence of price maintenance, highly regarded nationally advertised merchandise often is sold at a higher than market price (as compared with other merchandise generically the same), although in the past much of such merchandise on occasion was sold at a low price for leader purposes. And now through Fair Trade legislation the producer of branded merchandise may legally set a price below which the retailer may not go.

6. Custom, finally, has an important influence on the price of some products. Some merchandise, in other words, is sold at what is termed a *customary* price. Such items as gum, packaged candy, and

[1] Such a store is S. Klein's in New York City. It is suggested that the student prepare a short report on the methods employed in this exceedingly interesting serviceless operation.

[2] Likewise, manufacturers make mistakes in prognosticating consumer wants from time to time. Merchandise so manufactured is sold at a price having no very great relationship to cost.

periodicals fall into this category. The retailer has little control over the retail prices of such products regardless of the cost to him.

One may conclude that in most instances retail prices are set not according to formula but according to the position of the retailer in the market. Although the retailer may arbitrarily set his prices at any point he pleases (except for those articles whose retail prices are maintained by the producers), he may not do so with impunity. Competition, the desirability of and the elasticity of demand for the merchandise offered, as well as the reputation of the retail establishment, all are important price factors. The importance of each element depends upon the type of product and the market in which the retailer operates.

4. The One-price System. The pricing of merchandise at the retail level is very different today from what it was 75 years ago. At that time charging one price to all customers for a merchandise item was almost unknown in certain fields. The term *one price* means, note, that the same price is charged to everyone for an item of merchandise without higgling; not that all commodities in the store are sold at the same price (as in the case of Regal Shoes).

In the 70's of the last century it was typical of a clothing merchant when approached by a prospective customer to consult the code numbers on the ticket attached to the item and, with an eye to the probable wealth and astuteness of the customer, to name a starting price from which he was prepared to retreat to a considerable extent during the process of bargaining. That is, a system of personal discrimination was practiced in many of the retail trades.

This practice was disadvantageous from several viewpoints. On the one hand, it did not make for consumer good will toward the business concern. At the same time it was costly of sales time expended in serving customers. Finally, it retarded mass sales efforts because employed sales clerks could not be depended upon to bargain effectively without offending the customer. On the consumer side, certain individuals, aggressive in nature, who liked the rough-and-tumble of higgling, would gain at the expense of others who found such activity distasteful and difficult to accomplish. The time of the consumer also was a factor: think of the time which would have to be expended by the consumer-buyer nowadays in the already complex task of acquiring needed merchandise if an individual bargain had to be struck up before each sale was consummated.

The new one-price era was started around 1875 by John Wanamaker, who established and publicized the idea of an "inflexible one-

price policy."[1] There is little doubt but that the Wanamaker policy at once promoted consumer good will, reduced costs, and opened the way for modern mass merchandising activities.

Today most of our retail operations are based on the single-price system—the sale of drugs, groceries, clothing, variety merchandise, etc. However, even now certain types of operations are based on the bargaining between buyer and seller (*e.g.*, secondhand stores); certain others have similar methods except that higgling revolves about the item which is submitted in partial payment for the new product (*e.g.*, automobiles); and in still other operations, normally conducted on a one-price basis, bargaining is resorted to during periods of business inactivity when sales volume is sorely needed (*e.g.*, furniture stores).

One wonders where we would find the time and energy for marketing in this day and age if we had to pit our skill against that of the store sales representative each time we wished to acquire some merchandise item. It should be recognized of course that a multiple-price scheme as opposed to a single-price system is discriminatory in nature and that its purpose is to maximize revenue by obtaining or attempting to obtain the individual's full demand price for the item. Doctors do this in charging the wealthy more than the impecunious for their services. It is interesting to contemplate an economic system whose price structure would be predicated upon the ability to pay. It should be noted that certain types of merchandise operations depend for their very existence upon a one-price system. It is very possible that the one-price system goes too far in charging the same price for a product plus a minimum amount of service to one and for the product plus a maximum amount of service to another. Such is the situation in the case of department stores which sell merchandise without delivery and credit service at the same price they ask for the same product delivered to a distant address and for which payment may be deferred from 30 to 60 days or even more. As a result of this practice, buyers purchasing for cash who carry the goods out of the store are helping to bear the cost of credit and delivery extended non-cash-and-carry customers. Actually, from the standpoint of equitableness some differentiation in price should be provided for.

[1] Wanamaker advertisements of the period expressed the idea variously (see Joseph H. Appel, "The Business Biography of John Wanamaker, Founder and Builder"): "A fixed price marked in plain figures on each article and no deviation." ". . . that all customers buying at the same time should pay precisely the same price for the same quality of goods." (Pp. 66, 68.)

Some stores of course sell only on a cash-and-carry basis. Chain grocery stores usually are in this category. Chain department stores such as Penney's operate in this manner also, thus treating all customers in the same manner. For some years R. H. Macy and Company sold only on a cash basis and as a result claimed to be able to sell its merchandise at 6 per cent less than those not conducting their operations in this way.[1] Each of these in effect is an effort to avoid discrimination against a certain class of customers.[2] It is possible that this same end could be better accomplished by a two-price system.

5. Price Lining. The student of consumption economics should be cognizant of several other phases of the retail-price problem. One of these has to do with the lining of prices. The student is very apt to think that merchandise is first purchased and then priced. In shopping lines, often, just the opposite is true. The wise retail-store buyer recognizes that there are price grooves in which consumers prefer to purchase. Thus a study of price lines in a number of cities a

[1] Macy's has deposit accounts through which customers build balances for the payment of items of high unit cost such as refrigerators, furniture, fur coats, etc.; on these accounts interest is allowed.

[2] It is common practice among retailers to mark up merchandise of the same generic type (women's coats, say) by a uniform percentage, regardless of the price of the item sold. That is, one coat costing $65 and another costing $16.25 might both be marked up 35 per cent on sales; thus the former would be offered for $100 and the latter for $25 at retail. It should be clear, as a result of a little reflection, that although percentage markups are uniform such a scheme might be considered discriminatory against the purchaser of a more expensive garment. That is, the dollar markup retained for the purpose of carrying expenses and providing profits is $35 in the first instance and only $8.75 in the other, while the actual expense attending the sale of the more expensive item (including procuring the garment purchased) is little, if any, more. The main reason for this practice, no doubt, arises out of the fact that those paying highest prices for such products at once can afford and would not object to carrying a larger share of the expense than that actually incurred through the services rendered.

This practice has certain questionable aspects which should be considered by the student of consumption economics. One phase of this problem is particularly significant: If the dollar expenses were evenly divided, those paying lower prices might find better garments more nearly within their reach financially. That is, a 50-dollar garment having a $17.50 markup and a 25-dollar garment having an $8.75 markup, under the present system, would be sold at $45.67 and $29.38 respectively under a "nondiscriminatory" markup scheme. The student may wish to check this point of view with those actually engaged in conducting business in the retail field. It is suggested that the student seek a definitive answer to the question as to whether discriminatory markups, in the sense utilized here, are advantageous or disadvantageous from the standpoint of consumer-buyers.

few years ago revealed that most popular-priced comforters fell into the following price groups:[1]

Comforters	Most patronized price lines	Second most patronized price lines	Third most patronized price lines
Cotton filled, cotton covered........	\$2.95–\$2.98	\$1.98	\$3.95–\$3.98
Wool filled, cotton covered..........	\$3.95–\$3.98	\$4.95–\$5.00	\$5.95

The store buyer, then, goes to the market with the idea of buying merchandise to sell at a particular price. Manufacturers cognizant of this situation consequently often produce goods to sell in particular wholesale price lines. In the short run, in some lines price actually determines cost of product rather than the reverse. That is to say, the quality of the merchandise produced (and hence its cost) is determined by the price line in which the goods are to be placed.

Popular price lines are limited in number. Usually the wise store buyer will concentrate his sales effort on a very few lines—five or six at the most. When such a rule is adhered to, the vendor and consumer may both be benefited, since the latter is less apt to be confused by a large number of items possessing minute quality gradations and the former finds his selling costs reduced since he can do business with smaller stocks and need not spend so much time with each customer.

The consumer should compare merchandise *quality* between the price lines of each store as well as that of the lines offered by the several retail outlets. Goods that appear identical at first glance often reveal marked differences when examined carefully. Moreover, when price levels move upward, price lines often remain stable with the result that standards of merchandise quality suffer.[2]

6. Special-sales Prices. Special sales, common in large retail institutions selling shopping merchandise, are those in which special inducements are offered the consumer in the form of lower than usual prices. According to Prof. Paul H. Nystrom,[3] 25 to 35 per cent of all furniture and home furnishings are sold at special sales as well as large

[1] Hugh B. Killough, "Economics of Marketing," p. 279. See TNEC Monograph No. 1, "Price Behavior and Business Policy," 1940, referring to the index of that publication for several different discussions of various aspects of the subject.

[2] When absolute standards of quality exist—such as obtain in respect to butter—changes in the supply-and-demand relationship must reflect themselves in price fluctuations.

[3] P. H. Nystrom, "Retail Store Operation," p. 199.

proportions of radios, furs, and apparel. From the standpoint of the retail institution, the special sale is a way of securing greater sales volume.

According to Professor Nystrom, "... it is very difficult to justify a special-sales price on any rational ground. If it is a markdown from a higher price [he argues] it can be interpreted in either of two ways. It either indicates that the store has made an error which it desires to correct by repricing, or the store is trying to buy custom by offering a premium in reduced prices. If the store has made a mistake in its judgment of the value of the merchandise, then it may be necessary to try to find customers at lower price levels. A thing is worth what it will sell for and if it won't sell at the first price it isn't worth that price. To claim such a value is a misstatement.

"A second reason for a marked-down price is to pay or bribe people to come to the store. You spend money in advertising in telling them to come ... [in] the hope that you may be able to sell them some goods on which you can recoup your advertising expense and, if possible, make a little money besides. If markdowns and comparative prices do not represent mistakes of judgment and are not intended to serve as gifts or bribes, then ... what are they?"[1]

Professor Nystrom's view though acceptable in the main fails to emphasize certain aspects of the device that are of particular significance to the consumer. Some special sales, for example, are of the clearance type, special inducements being offered for the purpose of moving merchandise quickly. Purchases under such circumstances may be advantageous to both vendor and consumer. If a shopper is discriminating and does not mind purchasing merchandise which is not in complete favor with respect to style or for which there is not a full stock of colors and sizes from which to choose, he can make excellent "buys" at special sales since prices then are cut deeply in order to move goods immediately. Again an astute store buyer, working closely with a friendly source, will from time to time be able to arrange for the manufacture of certain commodities during a quiet season. Such merchandise can be offered at less than market because all costs need not be covered. This is beneficial to the manufacturer, since his loss is less than it would be if he failed to obtain this business. The store gains as well, since it utilizes its facilities more intensively. The lower-than-usual price obviously benefits the customer also.

Quiet buying seasons in the retail market also give rise to special sales at times. In the sale of furniture, some seasons of the year are

[1] *Ibid.*, pp. 207–208.

not active buying seasons. In order to utilize the store's facilities at a time when they are incompletely utilized, special inducements are made. If the response is favorable, the tendency is to reduce retail costs as a percentage of sales. The result may be mutually beneficial to retail concern and consumer under these conditions, also.

It should be pointed out, however, that the consumer in order intelligently to take advantage of special offerings must select the store carefully and must also keep merchandise standards firmly in mind. The latter is tremendously important since the reason for a special price on an item might actually be the fact that the merchandise has proved unsatisfactory.

Little justification can be offered for special sales of the "bribe" variety. If the *regular* store customer fails to purchase specially priced merchandise during such a sale, however, he may indeed pay a penalty in the form of higher average prices throughout the year.

7. Private-brand Prices. The term *private brand* in connection with an item of merchandise means merely that the brand is not sold by other distributors in the same stage of distribution. A better term, perhaps, would be *distributors' brand,* since most of the so-called private brands are controlled by marketing firms. Distributors' brands, of course, compete with manufacturers' brands in the market place; usually they are not extensively advertised, and most often (as is indicated by FTC figures) comparable merchandise under distributors' labels is sold at prices lower than those charged for standard brand merchandise.[1] This latter point is brought out in more detail in Table 55.

"Manufacturers' nationally advertised brands are often sold on very narrow margins."[2] That is, certain manufacturers, enjoying the

[1] Comparison of prices of chain private and competing standard brand commodities:

Type of merchandise	Number of commodities	Prices, private brands	Prices, standard brands	Per cent of private brands less than standard
Groceries.......	44	$92.22	$105.21	12.3
Drugs..........	41	23.79	28.33	15.7
Toilet articles...	12	5.44	7.40	26.5

SOURCE: FTC, "Chain Store Buying," 72d Cong. 2d sess., Doc. No. 142 pp. 93, 96.

[2] P. D. CONVERSE and H. W. HUEGY, "Elements of Marketing," 2nd rev. ed., p. 269.

TABLE 55. INDEXES OF PRICES OF NATIONALLY ADVERTISED GROCERY AND DRUG ITEMS BASED ON PRICES OF COMPARABLE PRIVATELY BRANDED MERCHANDISE ITEMS

Groceries (1937)*			Drugs (1938)†		
Items	Privately labeled item prices	Nationally advertised item prices	Items	Privately labeled item prices	Nationally advertised item prices
Baked beans, 16 oz.	100	106	Absorbent cotton, 1 lb.	100	117
Baking powder, 8 oz.	100	130	After-shaving lotion, 5 oz.	100	186
Cocoa, 8 oz.	100	143	Amber petroleum jelly, 16 oz.	100	115
Coffee, 1 lb.	100	140	Analgesic balm (tube)	100	190
Condensed milk, 14 oz.	100	125	Aspirin (100)	100	454
Cornflakes, 12 oz.	100	130	Cod-liver oil with viosterol, 16 oz.	100	165
Evaporated milk, 14½ oz.	100	107	Effervescent laxative salt	100 (12½ oz.)	140 (12 oz.)
Farina cereal, 28 oz.	100	147	Halibut liver oil and viosterol (liquid), 5 cc.	100	189
Gelatin, 1 oz.	100	200	Milk of magnesia	100 (16 oz.)	152 (12 oz.)
Gelatin dessert, 3¼ oz.	100	122	Mineral oil, 16 oz.	100	238
Ketchup, 14 oz.	100	153	Nursery talcum, 10 oz.	100	162
Malted milk drink, 6 oz.	100	153	Palm and olive shaving cream (giant tube)	100	137
Rolled oats, 20 oz.	100	133	Prophylactum antiseptic	100 (16 oz.)	151 (14 oz.)
Salad dressing, 1 pt.	100	131	Yeast tablets (100)	100	126
Tea, 4 oz.	100	153	Zinc ointment (tube)	100	172
Average of indexes	100	138	Average of indexes	100	177

* Adapted from price data contained in a handbill circulated by the Great Atlantic and Pacific Tea Company in New Orleans and reproduced in *Advertising and Selling*, Jan. 14, 1937, p. 5.

† Adapted from price data contained in an advertisement of R. H. Macy and Company in the *New York Journal*, Apr. 26, 1938.

advantages of strong consumer preference or a quasi-monopolistic control of the market, are able to command the retail distributors' services at lower cost. Hence the retail distributor, adversely affected in his attempt to earn profit margins in keeping with expenses in a sense is forced into private brand promotional activities.

In contrast to the manufacturers' policy of charging what the traffic will bear,[1] private brand prices are more closely related to costs. One large western chain enterprise—typical of many, no doubt—"will not price a controlled brand lower than a competing brand unless the price difference is justified by actual cost differences."[2] That there often is room for lower retail prices when the cost formula is applied is undeniable. In some fields—*e.g.*, drugs and cosmetics—the price based upon cost is only a fractional amount of the price set by the manufacturer.[3] While this is perhaps not typical of all fields, in most some difference obtains. This means, then, that there is plenty of opportunity for price-minded distributors, even while paying suppliers the full price asked by them and while retaining more adequate margins for themselves, to sell merchandise to consumers at lower prices. To summarize, privately labeled merchandise typically (1) costs the distributor less (because there is little if any element of quasi

[1] "The manufacturer who develops a demand for his goods by advertising may, because of this demand, be able to secure a higher price for his goods." *Ibid.*, p. 269.

[2] *Safeway Policies*, Jan. 1, 1941, p. 14. However, a firm pricing in this manner sometimes experiences what may be termed *inverse elasticity* conditions; that is, consumers refuse to buy at the low price because of a suspicion of low quality. One firm which ran up against this interesting demand situation raised the price of the article to a point just below that charged for the nationally advertised item with satisfactory results.

[3] The following list of USP and NF preparations, with their costs ready-made and to make, is illustrative:

Preparation	Cost to buy	Cost to make
Brown Mixture, pt	$0.55	$0.31
Elixir sodium bromide, pt	0.70	0.27
Elixir potassium bromide, pt	0.80	0.30
Syrup hydriodic acid, pt	0.78	0.18
Dobell's solution, gal	1.25	0.25
Calamine lotion, gal	1.50	0.75
Fehlings solution (alkaline B), lb	1.00	0.40
Benedict's solution, pt	0.60	0.25

SOURCE: TNEC Monograph No. 1, "Price Behavior and Business Policy," p. 370.

monopoly present), (2) is sold to consumers at lower prices, and (3) yields the merchant a larger margin in terms of per cent of sales. Whether the vendor makes more money on it than on the sale of nationally advertised merchandise depends upon (a) the volume of such sales and (b) the costs connected with promoting the merchandise.

Private brands usually are handled by chains, but not to the exclusion of standard brands. At the time of the FTC Inquiry it was found that the total proportion of private brand business done by chains was a little more than 18 per cent of total chain sales.[1] This figure, of course, includes sales of those chains—Penney's; Gallen Kamp's; Sears, Roebuck, and others—whose proportion of own-label merchandise is unusually high. In some fields—groceries for example—the figure is somewhat lower. In normal times opportunities for savings by purchasing privately labeled merchandise are available to consumers in many lines.

It must not be imagined that the private brand is exclusively a chain-store phenomenon. Indeed, private-brand goods constitute one of the principal features of some of the groups of independent merchants doing business by cooperative methods (IGA, Red and White, *et al.*).[2] These independent groups in fact probably utilize private brands just as extensively as the ownership chains.[3] Actually 72 per cent of all cooperative organizations reporting to the FTC had their own brands—some, indeed, manufacturing such merchandise themselves.[4] Two-thirds of the reporting cooperatives, moreover, said they intended "to increase further the number of their private brand items subsequently."[5] The reasons for handling private brands given by these independent groups were very similar to those claimed by the chains—typically, larger gross profit combined with lower prices to the public.[6]

Department stores usually handle private labeled merchandise also. The May Company in Los Angeles, Denver, Baltimore, etc., for exam-

[1] FTC Chain Store Inquiry Doc. No. 13, p. 129.

[2] FTC Chain Store Inquiry Doc. No. 12, p. 127.

[3] For example, at the time of the FTC Inquiry IGA had between 200 and 300 privately labeled items. Red and White had over 600 items covering some 90 per cent of the packaged merchandise carried by the average wholesale grocer. *Ibid.*, pp. 127, 128.

[4] *Ibid.*, pp. 128, 131.

[5] *Ibid.*, p. 134.

[6] *Ibid.*, p. 133.

ple, has a large list of items sold under its own brand. Meier and Frank of Portland, Oreg., and R. H. Macy of New York City—typical of scores of others—are doing the same thing. The latter aggressively promotes "Macy's Own" merchandise and features it in that establishment; it has also been distributed—before the war, at least—in some of the large Eastern supermarkets along with the supermarkets' own privately labeled products. The best known to the public of all private brands, however, are those of the wholesalers, although it should be noted that these often are promoted and priced differently from those sold by retailers.[1]

It is very probable that a larger proportion of total sales before the war was in privately branded merchandise than, say, ten years previously. The private brand is a problem for the unaffiliated independent merchant, and to some extent at least he has been instrumental in intensifying it as a result of his own efforts, through the establishment of Fair Trade and Unfair Practices acts, discussed later. In other words, because of "retailer-protective" legislation, standard and private brand retail-price differentials are much greater now than heretofore. This means simply that the promotion of non-nationally-advertised merchandise by mass distributors now is even more attractive than it was before such legislation was put into effect; that the more alert and aggressive retailers merely are taking advantage of opportunities presented them by the new situation.

8. Retail Market Prices. For most commodities in a given market at a given time there is not a single retail market price, but a number of retail prices. Yet the differences among the prices charged for the same article by various shops are kept within fairly definite limits. In other words, although the retail prices at which articles are sold by different shops on the same day in the same locality are not identical in the majority of cases, they bear a close relationship to each other. That is to say, while there is no single retail market price for identical articles, there is what might be termed a retail *market price zone.*

At any one time in any retail market, there are two sets of opposing forces at work. One set of forces creates a tendency toward a uni-

[1] Most people recognize such well-known names as Reid, Murdoch's "Monarch" brand; Sprague, Warner's "Richelieu"; Sussman and Wormser's "S & W"; Haas Brothers' "Trupak" and "Dodge" brands; and Haas Baruch's "Iris," for example, since these—unlike many of the others—are extensively advertised. However, as was suggested above, most of these, in contrast to the situation usually existing in the sale of goods under private label, are so-called *quality brands* which sell at premium prices.

formity of retail prices for identical merchandise; the other, much stronger, makes for a disparity in retail prices.[1]

The forces underlying the tendency toward a quasi uniformity of retail prices are worthy of consideration. The one-price policy of retailers, for example, has the effect of eliminating wide disparities. Seventy-five years ago, bargaining between vendor and the consumer-vendee was quite common. Hence, while retail prices may have been nominally uniform under such conditions, actual prices were likely to be poles apart. This absence of higgling, then, tends toward a uniform differential as among retail establishments. To put it in another way, where higgling exists there is a complete absence of retail-price uniformity.

Branding and advertising tend toward a uniform price situation (although there are some exceptions to the general rule), especially since price-maintenance legislation now allows contracts calling for minima below which no retailer can go. Even in the absence of such contracts, retail advertising keeps people informed with respect to prices. This also tends to iron out differentials.

Shopping habits of individuals are now more effective than ever in keeping price differentials among establishments down to a minimum. Automobiles and good roads now make it possible for the consumer to take advantage of lower price offerings at some distance. The retailers, consequently, must keep their prices in line, certain types maintaining comparison shopping bureaus for the purpose. Obviously, price lining makes for a tendency toward retail-price uniformity, since each similarly situated retailer uses the same factual basis upon which to set his prices.

The foregoing should not be construed as a contention that there is an absolute uniformity in prices as among establishments. The consumer has only to look about him to see that retail prices in most lines are not identical. Its purpose is merely to explain why there is *any* degree of uniformity in the prices of various retail establishments.

Because of an infinite number of possible quality variants, price differences appear greater than they actually are. Silk stockings, for example, can be purchased for 49 cents or less or for $4.95 or even more. Unobservant buyers are apt to think in terms of prices only, assuming a uniformity of quality when such an assumption is definitely untenable. This, of course, gives rise to statements made by consumers to the effect that though one store is charging $1 for a

[1] M. P. McNair, C. I. Gragg, and Stanley F. Teele, "Problems in Retailing," pp. 137–140.

certain item they can get "identically the same thing" at a competitive institution for 49 cents. While this is true at times, often it is not.

As has been suggested, however, there are actual price differentials as among various institutions for the same items. We have mentioned (Chap. XIV) that the market for any type of commodity is made up of thousands of trading areas. Some cities have a score or more of miniature market areas. Conditions from area to area differ with

TABLE 56. COMPARISON OF PRICES IN TWO WESTWOOD VILLAGE, LOS ANGELES, MARKETS ON IDENTICAL ITEMS,* JANUARY, 1944†
(In terms of index numbers, cash-and-carry store prices = 100)

Merchandise items	Cash-and-carry price index	Service enterprise price index
Campbell soup (asparagus), standard size	100.0	127.3
Carnation milk, 14 oz	100.0	115.8
Chase & Sanborn coffee, 1 lb	100.0	110.3
Crisco, 1 lb	100.0	108.3
Del Monte tomatoes, 1 lb., 12 oz	100.0	129.4
H-O Quick Oats, 1 lb	100.0	108.3
Iris yellow cling peaches, 1 lb. 14 oz	100.0	100.0
Karo syrup (dark), 1½ lbs	100.0	113.3
Kraft pimento cheese (glass container)	100.0	181.8
Sugar (Sea Island)	100.0	.....
(C and H)	.....	115.4
Sunsweet prunes, 1 lb	100.0	120.0
Washburn-Crosby flour, 10 lb	100.0	123.3
Average	100.0	118.5

* With the exception of sugar, although both brands were cane.
† Survey conducted as a class exercise by one of the authors.

respect to income of residents and their buying habits, the degree and type of competition, etc.; although the existence of interarea competition keeps prices from getting completely "out of line," differences may obtain because consumers find it inconvenient to go too far out of their way to make purchases. Thus grocers or druggists located conveniently to a certain residential district may price merchandise 10 or even 15 per cent higher than downtown shops.

Closely allied to the foregoing situation is the fact that when buying goods the consumer purchases not only the bare product, but with it a bundle of services. One of these services is the factor of convenience. Others such as credit, dependability, pleasant surroundings, carefully trained salespeople, telephone orders, and free delivery, however, are equally important. Many people are quite willing to pay higher

prices under these conditions, since they are in effect purchasing goods plus—to them—valuable service, although part of this willingness, very likely, is due to ignorance. Conversely, as has been suggested previously, many consumers demand commodities stripped of all service. Chain establishments often cater to the latter type of clientele. The fact that there are such differences makes for a lack of price uniformity. The data in Table 56 are illustrative of this situation.

Different retailers have varying policies regarding changing their prices to conform with wholesale movements. Hence, some absorb such price changes; others alter prices immediately upon receiving notice of a change by their suppliers; still others postpone action. Moreover, variations in the timing of special-sales events make for price differentials. Some retailers have monthly or semiannual events. Some, indeed, avoid special events entirely, taking markdowns as they are required. Millinery syndicates, for example, mark merchandise down daily. As a result, at any one moment of time prices differ as among stores.

Uniform prices are nonexistent even for identical staple articles offered by stores in the same trading district. A study of grocery prices in New York State reveals price differences of several types:[1] (1) those existing *between sales prices and regular prices* on identical items in the same store; (2) those occurring on the same day in *different stores;* and (3) those appearing on *different quantities* in the same store.

"To what extent individual buyers can profit by these differences in prices, depends upon the goods to be bought and the selling practices of the stores that can be patronized. With the various means of saving, however, most buyers have opportunities for taking advantage of some differences in prices on a large part of their groceries.

"Since grocery articles are relatively inexpensive, buyers cannot expect to save more than a few cents on each unit by taking advantage of differences in prices. These small price differences, however, are significant because the number of units bought at one time or over a period of time, as a month or a year, is usually large enough for the savings to make a sizable total. A difference of 10 to 15 per cent in the year's expenditures for groceries, through buying at the most advantageous prices, may result from the small savings on individual articles."

[1] L. Doman, "A Study of Price Differences in Retail Grocery Stores in New York State," *Cornell Agr. Exp. Sta. Bull.* 665, p. 46.

Considering the fact that there exist actual price differentials in identical items, the consumer, in order to obtain the best values, must perforce shop. This means that the astute consumer-buyer must investigate various retail sources in convenience goods, as well as shopping lines. An investigation into comparative prices of grocery or drug items is perhaps just as desirable as one comparing prices and qualities of merchandise handled by department stores.

Moreover, in drug products particularly substantial savings may be effected by purchasing privately branded merchandise in place of the nationally advertised brands. When comparing merchandise *values*, however, the consumer must consider not only prices charged but product quality offered and the service rendered by the seller. Each consumer must individually evaluate these several elements. Until this is done, intelligent utilization of comparative price data is impossible.

Questions

1. Are retail prices of identical articles the same in the same market area? If not, how can such differentials exist?

2. Name the one or two most important elements entering into the retail price of the following: high-fashion fur coats; Bayer aspirin; red roses in January; lettuce; bread; nonbranded men's shirts.

3. How much would a fully informed consumer buying public do toward improving the quality of retail competition? What other factors also are of importance?

4. Is competition more intensive in some retail lines than others? Give examples and explain why this is so.

5. Go into a chain or voluntary chain grocery store and make a detailed comparison of prices of nationally advertised against privately labeled merchandise in a certain line (a certain type of cereal or canned vegetable, say). Write a summary statement on all price differences found.

6. Give some examples of price discrimination found in the retail field. Can one conclude from these cases that price discrimination is necessarily socially undesirable?

7. As a result of a study of TNEC Monograph No. 1, "Price Behavior and Business Policy," describe some retail price policies not covered in this text.

8. Should the one-cent sales usually employed by certain drug firms be classified in the same way as special sales held by department stores? Explain the difference, if any.

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CHAPTER XVI

RETAIL PRICE CONTROL BY LEGISLATIVE PROCESS

We have examined certain aspects of the pricing of goods and services at retail but have said little thus far about the government's role in the pricing process. Until comparatively recently, when goods were purchased for resale the dealer was free to do what he pleased with them—to sell them at any or indeed at no price, if he so desired; until even more recently, those selling *services* were unrestricted as regards prices charged to consumers. In recent years all this has changed—now in most states many branded articles must not, under penalty of law, be sold for less than the minimum price incorporated in a contract issued by the manufacturer; in many states no merchandise may be sold at less than cost with certain exceptions; in some states special price-floor legislation exists for certain specific services (barbering, for example) and certain specific commodities (milk). The following pages are devoted to analyses of these types of measures, most if not all of which have the effect of offsetting to some extent the advantages of consumer-protective legislation discussed in an earlier chapter.

1. Fair Trade Laws. Retail-price maintenance is the setting of retail prices by the producer and his insistence that this price be maintained even after the article has left his hands. That is to say, the producer is allowed to control the price of his product right through the channels of distribution to the consumer. Under such a system the retailer is obliged to sell the product not at a price which he himself sets, but at one specified by the manufacturer thereof.

Until a few years ago, the maintenance of resale prices by means of a contract between manufacturer and distributor was definitely illegal. Vendors not only were legally proscribed from entering into contractual relations with buyers regarding the maintenance of resale prices but they were not even allowed, by implication, to solicit agreements from buyers to uphold retail prices. Any cooperative arrangement between producer and distributor designed for the purpose of informing a producer of instances of price cutting was declared illegal as well. The courts decided, furthermore, that all articles, regardless of patent

or copyright privileges, had the same status with respect to resale-price control. Patent or copyright privileges, in other words, carried with them no special rights with respect to retail-price control. From this it can be seen readily that resale-price maintenance, in interstate transactions at least, had little legal support under previously existing conditions.[1] Even in this earlier period, however, the courts held that a producer could legally:

1. Announce his retail prices to the trade.
2. Refuse to sell to those who did not adhere to the prices so announced.
3. Even threaten to refuse to sell to price cutters.[2]
4. Inform himself of the existence of price cutting by means of the public prints but not use any cooperative means to do so.[3]

Aside from this somewhat impracticable method of maintaining resale prices (that of refusing to sell), the vendor had several other more or less satisfactory methods that could be utilized in an attempt to maintain prices. He could, for example, reason with price cutters, explaining to them that price cutting would eventually have an adverse effect on the retail market since others would follow and margins would thus become narrower. He could, if it seemed advisable, use exclusive dealerships and assign to each dealer a definite territory, a sort of quasi monopoly in the sale of this particular item. The theory behind this was that the dealership would become so valuable that the dealer would take no chances on offending the vendor, lest he lose his valuable property. Finally, a producer-vendor could establish genuine agencies and, since an agent acts for his principal without transference of the title to goods, the original vendor could set and maintain any price that he chose.[4]

For the most part, the methods that could be utilized in the maintenance of resale prices before the enactment of Fair Trade laws were impracticable. Manufacturers and independent retailers, therefore, fought for legislation that would legalize an effective price-maintenance program. California was in the vanguard in enacting laws for this purpose. Since the enactment of the 1931 legislation (amended in 1933) in that state, 44 other states have followed the California

[1] One early case was *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373 (1911). In this the court condemned resale-price maintenance because, it argued " . . . the public is entitled to whatever advantage may be derived from competition in subsequent traffic."

[2] *United States v. Colgate & Co.*, 250 U.S. 300 (1919).

[3] *Federal Trade Commission v. Beechnut Packing Co.*, 257 U.S. 441 (1922).

[4] *United States v. General Electric Co.*, 272 U.S. 476 (1926).

lead. The campaign waged by the independent retailers to bring about enactment in the various state legislatures—especially by the Retail Druggists Association—was unprecedented in the "cleverness" displayed and the success achieved.[1]

The so-called Fair Trade laws in the various states have more points of similarity than points of difference. Indeed, many states have copied the California act verbatim. This act, in effect, legalizes contracts between vendors and vendees regarding the maintenance of prices set by the manufacturer of branded merchandise. Not only are parties to the contract held to its adherence, but all others who resell the manufacturer's product as well; which means, of course, that even though chain distributors refuse to enter into such contracts they must sell their product in accordance with the contracts signed by others in the trade. This "nonsigner clause," so called, has been upheld by the United States Supreme Court.[2]

The law specifies, however, that no horizontal agreements can be entered into. That is to say, distributors may not (according to the law) band together for the purpose of maintaining retail prices although in a real sense the law forces horizontal action. Moreover, the law specifies certain exceptions even in the case of vertical contracts. Thus goods "may be resold without reference to such an agreement in the following cases:

1. In closing out the owner's stock for the purpose of discontinuing distributing such commodity.

2. When the goods are damaged or deteriorated in quality and notice is given to the public thereof.

3. By any officer acting under the orders of any court."

In June, 1937, a Federal statute—the Tydings-Miller law—came into existence making legal interstate price-maintenance agreements

[1] One device which seems to have been utilized with great effectiveness, particularly during the campaign to enact the Tydings-Miller bill, was a system of contact committees called the Captain Plan. According to a story in one issue of the NARD *Journal* ("Report of the Federal Trade Commission on Retail Price Maintenance," submitted to Congress Dec. 13, 1945, p. 65): "These committees, like arteries, were spread all over the Nation, in every county, and when steps were needed to further the just causes [sic] for which the association was fighting, these committees were called into action. In the historic instance when the enabling bill seemed blocked, this plan made it possible to place the 'back home' sentiment so effectively before the legislators and the President that the blockade was dislodged and the bill went forward."

[2] In *Old Dearborn Distributing Co. v. Seagram Distilling Corp.*, 299 U.S. 183 (1936) and *The Pep Boys, Manny, Moe and Jack of California, Inc. v. Pyroil Sales Co., Inc.*, 299 U.S. 198 (1936).

between states having Fair Trade laws. This law supports the intrastate legislation and presumably makes valid (1) contracts between vendors and vendees located in different states and (2) the extension of control past state lines where contracts exist in any one state. Characteristically, this law was passed in the form of a rider to a District of Columbia appropriation measure. Hence, the legal status of resale-price maintenance is now quite clear.

In evaluating resale-price maintenance from an economic standpoint, the various conflicting interests should be examined. On the one hand, some manufacturers of branded merchandise argue that price cutting is definitely harmful to them for at least two reasons: (1) Their good will is used by the price cutter to the manufacturer's disadvantage. The price cutter, in other words (the producer argues), uses his product as a leader, often selling the item for less than invoice cost. The consumer, as a result, accepts the cut price as the standard, refuses to pay more. (2) Because of this condition, independent retailers attempting to sell the consumer merchandise at suggested price find it so difficult that they either refuse to handle the manufacturer's product or exert strenuous selling effort in another direction.

The price cutter (the large merchandising institution), on the other hand, argues that his costs of doing business are less because of large volume and efficient management and he should be permitted to pass part of these "efficiency savings" on to the consumer. In any case, he argues, when he makes an outright purchase of goods he should be able to dispose of them at any price he pleases.

The independent retailer (and, obviously, the wholesaler, too) feels that the large-scale price-cutting institution is ruining his business since the price advertising of such concerns diverts customers from his own to the chain institution. The consumer, he contends, patronizes him only for stamps and magazines and for items forgotten on a shopping expedition. He insists that he is entitled to legal protection from his more efficient competitor. That effective resale-price maintenance *tends* to increase the independent sales of, say, nationally advertised drug items at the expense of the chain institutions there can be little doubt. It may be that chain-store growth has leveled off as a result of such legislation. (See Table 57.) However, the chains may be achieving success in offsetting a decline in the sales of price-maintained items by an increase in sales of non-price-fixed merchandise. Regardless of the effect of such legislation, one may challenge the soundness of a scheme whose purpose is that of destroying, in large

part, competition at the retail level and of subsidizing the less efficient distributive outlets at the expense of the more efficient.

The consumer's position is from our standpoint, however, the most important and should therefore be evaluated carefully. The intelligent consumer will recognize that less-than-cost selling is not clearly socially beneficial if only for the reason that specialists, some of whose positions in the field are economically justifiable, tend to be forced out of existence. Competent and conveniently located pharmacists and well-informed and helpful booksellers, perhaps, fall into this category.

Table 57. Proportion of Chain and Independent Drug Sales in California, 1933–1935–1939*

Type of establishment	1933	1935	1939
Independents	71.4	71.7	70.5
Chains	28.6	27.5	29.5
All others	....	0.8	
	100.0	100.0	100.0

* Adapted from "Census of Business" data for 1933, 1935, and 1939.

Such protection, however, should not go too far. Though legislation designed for the purpose of enforcing fair competition may be justifiable, that having as its purpose the freezing of existing techniques is definitely undesirable. The independent should not be protected on the ground that he is being forced out of business by more efficient retail institutions, since such a course would tend to perpetuate inefficiency. He might be so protected, however, if the large-scale retailer is competing *unfairly* in the market. The drawing of customers by means of less-than-invoice-cost prices in order to sell them goods of a higher-than-average markup probably cannot be defended economically. The sale of goods at low average prices as a result of low distribution expense probably can. Such a conclusion would indicate that resale-price-maintenance legislation is not justified, but that a prohibition of less-than-cost selling may be.

What is the immediate effect of Fair Trade legislation on the consumer-purchaser? Fortunately, from the standpoint of the consumer, "unidentified goods, approximately 50 per cent of the total retail business, are not legally subject to control under the acts. Producers' or owners' marks on many products are merely passive symbols of identification and not active selling instruments. In many instances the producers' interest in his mark does not run beyond the initial pur-

chaser. [Moreover] Fair Trade laws cannot effectively apply to perishables, style lines, finished goods affected by prices of raw materials, the second-hand market, and lines which bulk large in the consumer's budget and in which a small price rise will divert demand to another product."[1] In fact, the great majority of the contracts in existence are in the fields of drugs, cosmetics, books, and liquors.

Even when one confines one's analysis to an industry in which price maintenance is generally practiced, one should examine the situation

TABLE 58. COMPARISON OF ADVERTISED PRICES ON CERTAIN LINES OF DRUG PRODUCTS IN SAN FRANCISCO DURING THE PERIOD JAN. 1–JUNE 30, 1933, WITH 1934 CONTRACTUAL PRICES FOR IDENTICAL ITEMS*

Class of product	Number of products	Number of quotations	Average actual price as per cent of contractual prices	Percentage of increase, 1934 over 1933
Mineral oils	2	10	91.39	9.4
Antiseptics	9	58	84.34	17.3
Dentrifrices	6	49	82.10	21.8
Cosmetics	25	100	72.81	37.3
Deodorants	6	33	70.37	42.1
Food tonics and digestive aids	2	4	69.62	43.6
Salts	1	26	52.34	91.1
Soaps	3	36	46.19	112.2

* Adapted from E. T. GRETHER, Experience in California with Fair Trade Legislation Restricting Price Cutting, *Calif. Law Rev.*, September, 1936, p. 661.

from the point of view of several classes of consumer-buyers. From studies made by Prof. E. T. Grether,[2] it appears that in California the prices of drug items in cut-rate establishments from 1933 (before contracts were legalized) to 1934 (after such legalization) advanced over 30 per cent. Obviously, since different times are taken, extraneous influences—*e.g.*, a rising price level—may have had some influence on prices. Allowing an arbitrary fifth of the total difference for the effect of such influences, however, the increase still is almost 25 per cent. Differences in certain classes of products were very much greater than average, others much less; Table 58 indicates the extent

[1] Summary of a *Printers' Ink* article, Feb. 7, 1938 by E. T. Grether entitled "Why Most Retail Prices Will Escape Control under Fair Trade," appearing in *J. Marketing*, April, 1938, p. 336.

[2] E. T. GRETHER, "Experience in California with Fair Trade Legislation Restricting Price Cutting," *Calif. Law Rev.*, September, 1936.

of some of these changes and reveals that the increase was less than 10 per cent in mineral oils, over 100 per cent in soaps.

In the same study Professor Grether discovered that there was little difference between the 1933 and 1934 independent store prices. Indeed, if anything there was a slight decline in the price of the commodities making up the index between 1933 and 1934. Messrs. Wolff and Holthausen found somewhat the same situation in New York as Professor Grether found in California.[1]

Thus:

1. Those consumers who typically purchase nationally advertised drug items from independent retailing establishments have not been adversely affected by Fair Trade legislation.

2. Those who regularly purchase from cut-rate establishments must now pay almost a third more for nationally advertised proprietary items.

3. Those who have been buying substitute privately branded merchandise are probably not affected one way or another.[2]

As to the long-run effects of resale-price-maintenance legislation, no one can formulate them with any degree of assurance. To the degree that manufacturers can, by means of advertising, obtain consumer insistence for their brands, to that degree will they be successful. When this condition obtains, the contractual prices that are set are quasi-monopolistic, not competitive. If the consumer insists on Bayer aspirin, he has no alternative but to pay 59 cents per 100. Legalized price maintenance indubitably fosters more effective brand monopolies. Socially, such a tendency is undesirable.

Now that price maintenance is legalized, the consumer should be doubly skeptical about vendors' claims of product superiority. As has been mentioned previously, privately branded merchandise in many instances is of equal quality with the nationally advertised product and is priced at a much lower figure. For example, a price study of the drug field made by one of the authors reveals that, on the average, privately branded merchandise can be purchased for about one-half the amount charged for nationally advertised merchandise. The

[1] Reinhold Wolff and Duncan Holthausen, The Control of Retail Prices under Fair Trade Laws, *Dun's Review*, July, 1938, pp. 15–22, 44.

[2] This conclusion is not completely tenable, however, for sellers of privately branded merchandise may have felt that, since the prices of nationally advertised goods had been boosted, the price differential between these nationally advertised items and their own now was greater than necessary and thus may have increased their own prices.

greatly increased differential, incidentally, makes for greater chances of success for the sellers of substitute brands. It may indeed be that national advertisers will, in time, rue the day that they decided to maintain their prices at an excessively high level.

Large distributors have attempted to inform the consumer regarding equal-quality substitute products at materially lower prices. Sears, Roebuck in a catalogue some time ago suggested that the consumer "look for Sears own products marked X and save."[1]

TABLE 59. AVERAGE RELATIVE PRICES OF NATIONALLY ADVERTISED AND PRIVATELY LABELED DRUG ITEMS IN SELECTED RETAIL ORGANIZATIONS, 1938*
(Non-nationally advertised product prices = 100.0)

Type of merchandising establishment	Number of items	Non-nationally advertised product	Index of nationally advertised product prices
Leading New York department store	98	100.0	162.6
Mail-order house *A* (catalogue)	24	100.0	168.1
Mail-order house *B* (catalogue)	33	100.0	178.8
Large California chain	49	100.0	125.9
Independent cut-rate	47	100.0	214.4
Average of indexes		100.0	189.9

* Original study by one of the authors.

Macy's in New York, always militant opponents of resale-price maintenance, has done somewhat the same thing. In a series of advertisements—national and local—Macy's has called the consumer's attention to the high price of nationally advertised merchandise and

[1] The notice in the drug section of the catalogue continued, "Laws recently enacted in most states permitting the manufacturer of trade-marked articles to fix minimum selling prices in those states . . . have required us to raise the retail prices of those items to the prices set.

"If you are interested in buying quality merchandise at money-saving prices (and who isn't) . . . we suggest and recommend that you buy Sears own guaranteed products at prices not fixed under any State Laws, all marked with this emblem X which stands for First Quality at a Saving. This sign in a Sears' catalog means

X The identifying mark on Sears own goods
X A quality product
X The way to greatest savings
X Unaffected by any price fixing laws."

has suggested that he purchase Macy's private brand and save money.[1] Recently, incidentally, this store launched a campaign designed to break fixed retail book prices. Setting up a "book club," it offered consumer-buyers a 30 per cent discount in the form of a credit applying to the purchase of any book, based upon the purchase of every group of four club books. Needless to say, booksellers and publishers viewed this move with alarm. Sears has taken a similar step.

The large chains presumably have been directing the attention of the consumer to non-price-fixed merchandise also. As a result of such effort, a better informed body of consumers may be expected to develop. One may assume that such consumers will, in time, realize that privately labeled merchandise can be purchased advantageously. If so, one cannot but conclude that brand monopolies will lose some of their power, with the result that contractual prices on nationally advertised merchandise will decline. Consumers may aid in hastening the day by setting up defenses against emotional appeals and by selecting their merchandise on a more rational basis.

2. Unfair Sales Acts. A type of legislation in force in about 30 states in a sense complementary to Fair Trade laws is the *Unfair Practice* or *Unfair Sales* act, so called. This legislation, unlike the Fair Trade laws, is mandatory rather than permissive and by its terms prohibits sales at prices which do not cover costs when made with injurious purpose or effect, thus making illegal loss-leader selling by dealers. Cost, for statutory purposes, usually is composed of invoice or merchandise cost plus some part, or all, of the expenses of distribution. Thus, such legislation in effect establishes price floors[2] below which retail merchants may not sell their merchandise (except under certain conditions)[3] when the "intent" (usually),

[1] For example, in a Macy advertisement appearing in *Time* magazine, May 3, 1937, and headed, "The Consumer Will Now Decide," a detailed comparison was made between two brands of aspirin—a "well-known nationally advertised" brand and Macy's own. The consumer was informed that Macy's carried both, that each was manufactured in accordance with standards laid down by the U.S. Pharmacopoeia, and that the two were practically identical; but that the nationally advertised brand had been price-fixed by law and, hence, must be sold for not less than 59 cents while Macy's own was priced at 18 cents, which included a fair profit to Macy's and to the manufacturer.

[2] Often the measures which are called Unfair Practice acts have antidiscrimination provisions also.

[3] Such exceptions often include: (1) bona-fide clearance sales, if advertised as such; (2) perishable merchandise, when sold to forestall loss; (3) imperfect or damaged merchandise; (4) merchandise sold at final liquidation; (5) merchandise sold for charitable purposes; (6) merchandise sold to the government;

the "intent or effect" (in some instances), or the "effect" (in one case) is to injure or destroy competition.[1] While Unfair Sales laws purport to apply to merchants generally, so much policing is required that the law is effective only in those trades which organize their efforts toward enforcement, as in the grocery field. Some Unfair Sales laws provide that sales below cost are *prima-facie* evidence of intent to injure competition, thus throwing the burden of proof upon the accused, but such laws are of at least doubtful constitutionality. However, intent to injure is not particularly difficult to establish since the courts usually take a very broad view of this matter.

The idea of this type of legislation, ostensibly at least, is to forestall monopoly—to nip it in the bud, as it were—by proscribing predatory price cutting, *i.e.*, temporary price cutting intended to eliminate rivals. Only to the extent that this worthy end is accomplished is such legislation possibly justifiable; but it is difficult to exclude other effects in the accomplishment of such an end. It would seem that the real purpose of Unfair Sales acts is to protect certain groups of merchants, especially the independent operators in the grocery field, where, because of a sharper competition among brands, the invocation of Fair Trade laws generally is impracticable.

There are two main types of Unfair Sales acts in effect at present:

1. The *cost survey* type (which has been declining in popularity) provides that, in the absence of evidence to the contrary, the result of

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(7) merchandise whose price is made in good faith to meet competition. This latter point is somewhat redundant in view of the fact that, if price cutting is for the purpose of meeting competition, it is obviously not for the purpose of destroying competition. Some laws purport to provide that only *legal* prices may be met although such provisions are dubious constitutionally since, for one thing, a merchant would find it difficult if not impossible to discover whether his competitor's prices were legal.

[1] Price floor statutes requiring intent to injure competitors have been upheld in all cases, since in such legislation there is a reasonable relationship between the enactment and its legislative purpose. *People v. Kahn*, 60 P. (2d) Cal. 596 (1936); *Wholesale Tobacco Dealers' Bureau of Southern California, Inc. v. National Candy and Tobacco Company, Inc.*, 82 P. (2d) Cal. 3 (1938); *State v. Langley*, 84 P. (2d) Wyo. 767 (1938); *Associated Merchants of Montana v. Harry H. Ormesher and Bernard Blodgett*, 86 P. (2d) Mont. 1031 (1939); *Carrol v. Schwartz*, 14 A. (2d) Conn. 754 (1940); *Moore v. Northern Kentucky Independent Food Dealers' Ass'n.*, 149 S.W. (2d) Ky. (1941). Statutes which arbitrarily prohibit offers of sales at less than cost and require proof neither of injurious intent nor effect, on the other hand, have been struck down consistently. *New Jersey v. Packard-Bamberger Co., Inc.*, 8 A. (2d) N.J. 291 (1939); *Commonwealth of Pennsylvania v. B. P. Zasloff*, 13 A. (2d) Pa. 67 (1940).

a cost survey in a community will be "competent evidence" of an individual merchant's distribution cost within the meaning of the law.[1] Thus the cost of the merchandise (as evidenced by the invoice) plus the retail distribution expenses determined by a cost survey of similar firms in the community would establish a statutory cost figure below which the retailer may not sell his merchandise, assuming a presence of intent to injure competition.

2. The *fixed percentage* type (increasing in popularity), in which a figure is incorporated in the statute to be used as evidence of the cost of distribution in the absence of evidence on costs of the alleged violator of the laws. The range of statutory figures lies between 12 (for Arizona) and 0 (for North Dakota and South Carolina). In between we find 8 (Minnesota), 7 (West Virginia), 6 (most states), 5 (Maryland), and 4 (Pennsylvania). Thus, in this instance, total statutory cost would be made up of merchandise or invoice cost plus a percentage representing distribution cost as supplied in the particular statute. Again, no retailer may sell below a cost so determined with the intent to injure competition (except as noted).

It should be quite obvious by now that Unfair Sales laws are fundamentally different from Fair Trade laws. For one thing, as noted before, Fair Trade laws are permissive only (price maintenance contracts between manufacturer and distributor are permitted but not required); Unfair Sales acts, on the other hand, are mandatory (all retailers within a state having such a law theoretically come within its scope). The most serious difference between these two types of laws, however, is that under the Fair Trade laws the minimum prices acceptable to independent retailers are likely to be high enough to furnish a generous margin for all distributors and, since such figures once established apply to all sellers handling the particular product, much if not all of the price competition among dealers is eliminated. Unfair Sales acts, on the contrary, provide only that an individual's costs be covered, thus allowing for differences in efficiency among retailers,[2] although, as was mentioned, statutory

[1] Only about one-fourth of the approximately thirty Unfair Sales acts are of this type.

[2] Not only may a firm supply its own costs rather than rely on the statutory figure, but, according to one decision delivered in a lower court case (*State of Washington v. Great Atlantic and Pacific Tea Company*, S. Ct. of State of Washington in and for the County of King, No. 326814, Nov. 1, 1941), costs incurred in the sale of a particular commodity (cigarettes, say) may be segregated from others, and these, rather than the concern's average, may be considered the price floor. If this Washington decision were to become generally applicable,

cost may be substituted for individual costs. In the latter case, since the statutory cost of most of the states is modest (6 per cent is typical) as compared with typical actual costs of those engaged in retailing, there is plenty of room for price competition also.

It should be recalled that the ostensible reason for existence of price maintenance legislation is to curb the so-called "evil" of price cutting. The fact is that most price cutting is not an evil at all; it is, indeed, the very essence of competition. Much of the price cutting which has existed can be justified (1) on a basis of the existence of total operating-cost differentials as between individual retail outlets or (2) on a basis of expected sales volume, which under some circumstances allows the price cutter a greater amount of dollar gross margin than could be obtained if goods were sold at list prices. One unfortunate aspect of these laws is the emphasis on the alleged evils of price cutting, when actually this is the behavior we expect from competitors.[1]

In some instances there is perhaps a danger of "unfair" price cutting. Such a practice might, for example, arise from a monopsonistic advantage on the part of the large retail distributor. A more usual case, perhaps, is that of an implication on the part of the large-scale distributor that his low advertised prices are representative of a total price structure when in fact this is not true. The most serious type, possibly, is represented by "deep-cutting" a whole line,[2] with the effect of driving normally efficient retail

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aggressive price competitors would be freed, to some extent at least, from the legislative hobbles of the Unfair Sales acts, since the actual cost of handling certain types of commodities (particularly fast-moving items requiring little space) obviously is very low; hence, price floors perforce would be low.

[1] Semantics plays a part in this also. Who would support "cutthroat competition" or "chiseling?"—who would oppose "Fair Trade" laws?

[2] One might think, offhand, that the economic desirability of such circumscriptions would vary with the size of the percentage figure provided for in the statute; that the higher the percentage, the less chance the superior firm would have to pass on its savings in the form of lower prices. But this analysis is not entirely sound because, while "deep-cutting" on a *few* items is apt to develop when no floor exists, and no cutting is possible where floors are very high, smaller percentage reductions on *many* items might well be the normal phenomenon where moderate floors prevail in the absence of agreement. Consequently, a moderate price floor might accentuate price-competitive activities of retail concerns, since retailers would then be competing on a price basis in a wide range of products and not in just a few leaders whose prices had been deeply cut. For a fuller treatment of this point, see E. T. Grether, "Price Control under Fair Trade Legislation," pp. 316–320.

specialists to the wall. One cannot condone a legislative device, however, whose aim is to freeze an inefficient distribution structure. This seems to lead to the conclusion that Unfair Practices acts, whose purpose is to prevent deep price cutting by establishing a relatively low "cost plus" floor below prices, are economically preferable to any system which establishes fixed resale prices based upon full retail margins—*i.e.*, Fair Trade laws.

3. Milk Price-control Laws. The milk industry, like most other businesses, was in a very depressed state in the early 1930's. This was due in general to rapidly declining consumer incomes. As is generally known, the price of milk destined for sale in fluid form is higher than for that used in the manufacture of butter, cheese, etc. In 1931–1932 the prices of manufactured dairy products reached their lowest point in 25 years, so that milk producers (whose numbers were augmented by small independents who had lost their jobs in industry) attempted to turn more of their products into fluid milk channels.[1] In order to induce the purchase of increasing amounts of fluid milk by consumers with decreasing incomes, price cutting was resorted to, with demoralizing effect upon the markets. In some markets extralegal methods have been utilized to "stabilize" the industry over the years.[2]

Milk price regulation in the United States is of two major types: (1) measures operating under laws enacted by states and providing for control of prices within the borders of such states, and (2) the law enacted by the Federal government (Agricultural Marketing Agreement Act of 1937) under which milk marketing agreements may be effected between producers and distributors located in milksheds covering several states. Thus, because of their size and the fact that the sources of milk supply are located within their borders, some states find state legislation quite satisfactory for their purposes, while in others—whose sources of supply are located, in part at least, outside of the state's boundaries—control, if effected, must be of the Federal type. Each of these types of legislation has been upheld in the United States Supreme Court.[3]

[1] W. P. Mortenson, "Milk Distribution as a Public Utility," p. 6.

[2] R. W. Bartlett, "The Milk Industry," p. 78. See also Let 'Em Drink Grade A, and Milk in Chicago, *Fortune*, November, 1939, pp. 80 and 83.

[3] See *Nebbia v. New York*, 291 U.S. 502 (1934) and *U.S. v. Rock Royal Co-operative, Inc.*, 307 U.S. 533 (1939). For a summary discussion of these and other cases, see the chapter on Legal Aspects of Milk Control, Mortenson, *op. cit.*, pp. 107–136. For a fuller treatment of non-Federal milk price control see "State Milk and Dairy Legislation," Marketing Laws Survey, WPA, vol. III, Part One, pp. 1–96.

In contrast to situations in some of the states, the orders made under the Federal law now have to do only with the producer's price for milk, experiments on retail price fixing having been long since abandoned.[1] When 75 per cent of the producers in a milkshed desire such an order, a hearing is held and, if it is justified, an order may be instituted under the law; the price schedule set up under Federal government supervision is based on the maintenance of reasonable purchasing power with respect to things the farmers buy (feed, etc.), with differentials paid in accordance with the use to which the milk is put. There were 30 marketing orders of this type in effect for the dairy industry during the 1942 fiscal year.[2]

Some 26 milk-control laws have been passed by state legislatures over the years. Some of the state milk price-control laws apply only to prices paid to producers by distributors and do not extend to the setting of prices paid by the ultimate consumer for milk. Certain of the states, however—*e.g.*, California—have laws which apply both to producer prices and to consumer prices.

Typically, the responsibility of administering milk-control laws has been assigned to state milk-control boards under the direction of the state departments of agriculture. The board is charged with the task of setting up schedules of prices for each market area within the state; in some states the fixing of prices is mandatory and in others only permissive. In setting up such price schedules the California board must take costs into account in fixing the level, although obviously whether the product is sold for fluid or manufactured use has an important bearing on prices paid by individual purchasers; moreover, hearings are provided for so that protestants may make known their grievances. In general this type of legislation is designed to reduce the intensity of competition to the advantage of those engaged in the business, although ostensibly it is supposed to serve the general public interest.

As was indicated above, the California law among others provides for the setting of minimum retail prices as well as producer prices. In fact, in California a separate enactment covers each phase of the business; the one covering producer prices is known as the Young Act, while the consumer-price milk measure is known as the Desmond Act. Thus in California and several other states there is a schedule of prices below which no producer may go in selling his product to

[1] Primarily because such regulation could not be enforced. BARTLETT, *op. cit.*, p. 82.

[2] "Report of the Administrator of the Agricultural Marketing Administration, 1942," p. 65.

distributors, and a schedule of prices below which distributors may not go in the sale of their product to the ultimate consumer. (Actually there are two sets of prices provided for in the latter phase of the milk industry in California, a wholesale schedule and a retail schedule.)

While there may be some social justification for price-control measures in the milk industry, there are several fundamental objections to such control measures from the standpoint of the consumer, and particularly to the type which sets *retail* minima. In general, the legal minimum idea is only a fiction in the milk field; actually the prices set are usually so high as to allow no variation from them. Thus little, if any, opportunity is provided for price competition among sellers; that is, high-cost producers and distributors and those with low costs sell at the same price, with a resulting absence of pressure upon the former to reduce their costs. Evidently milk-control boards have given little attention to the problem of cost reduction and methods of narrowing distribution margins. In other words, not enough attention is paid by boards to improving efficiency with a view to reducing prices paid by consumers for milk.[1]

The type of law which extends price control into the retail field is more vulnerable from the consumer point of view than those merely fixing producer prices. In the first place, to the extent that retail minima are actually maxima, price competition among dealers is eliminated. That is, since each seller has to charge the same price regardless of the efficiency level at which he operates, the more efficient or aggressive sellers are not allowed to strive for increased custom through the medium of price concessions. In the second place (although this probably is not an exclusive product of milk-control legislation), retail differentials between Grade A and Grade B milk may be set too wide—wider than is justified by differences in the cost of butterfat content—with the result that many consumers ignorant of this absence of essential difference between the two choose Grade A when Grade B would serve equally well.[2] In the

[1] MORTENSON, *op. cit.*, p. 9.

[2] "Independent tests have shown that Grade A samples in New York have a butterfat content averaging only 0.15 per cent higher than Grade B samples. It is true that Grade A milk comes from better rated farms and the bacteria content is lower. But the difference is so slight as to be negligible except to gourmets. Yet the spread between Grade A and Grade B price in New York currently is 3c. If butterfat were to be bought in the form of butter at this rate, the price of butter would be more than $8 a pound." Let 'Em Drink Grade A, *Fortune*, November, 1939, p. 132.

third place, differentials between home-delivery and retail-store prices are much too narrow; in most instances where retail milk-control laws are in effect, the difference is only 1 cent at most. Some argue that the home-delivery–retail-store differential should be as much as 3 cents.

According to one writer, "The State of New York fixed minimum sale prices of milk from 1933 to 1937. When this resale price maintenance was abandoned, the price of milk in grocery stores in New York City was immediately cut, while it remained about the same on the wagon routes. By the end of 1940 the spread between the farmers' price for Class I milk and the New York City wagon delivered price seems to have been about the same as in Boston, but it appears that in New York City the differential between the wagon delivered price and the over-the-counter price was about 3 cents. According to the writer's information, in New York City the chain stores are increasing their sales of fresh fluid milk at the expense of the wagon routes. It would thus seem that in New York City the milk wagons are going the way of the bakery wagons. In other words, the New York milk wagons are increasingly serving the luxury trade, while those persons who desire to save pennies do so by getting their milk at the grocery stores."[1]

Similar evidence is to be found in other sections of the country. "The Arlington-Alexandria marketing area operates under the Richmond Milk Commission which sets prices to both producers and consumers in this area. From 1941 to 1944, both the home-

[1] ALBERT M. FREIBERG, Milk Delivery: Necessity or Luxury? *Harvard Business Rev.*, Autumn, 1941, pp. 121–122. This does not mean that without milk-control laws retail-store–milk-wagon differentials would necessarily widen, since materially lower over-the-counter prices are opposed by farmers on the grounds that pressure might result in lowering producer prices; also by distributors, who recognize that storekeepers are shrewder bargainers than ultimate consumers, and by milk-wagon drivers, who have a selfish interest in protecting this less efficient method of doing business. The latter particularly have been active along this line. For one thing, they have opposed the use of paper containers which encourage store purchases. The high (or low) point of labor tactics in one situation was reached in needling such containers with lemon-juice-filled hypodermic syringes, with the result that the milk soured and ill will was created toward the brand so treated. Let 'Em Drink Grade A, *Fortune*, November, 1939, p. 131. Incidentally, an attempt to charge 1 cent more for milk in paper containers was struck down by the Supreme Court of one state. *Lucerne Cream and Butter Co. v. Milk Commission of Virginia*, 29 S.E. (2d) 397 (1944); see also *American Can Company of Massachusetts v. Milk Control Board*, 55 N.E. (2d) 453 (1944).

delivered price and the store price to consumers in this area were fixed at 15 cents per quart. . . .

"Just across the Potomac in Washington, D.C., prices to producers are set under a federal order, but consumer prices are on a competitive basis. The home-delivery price in Washington from 1941 to 1944 was the same as in the Arlington-Alexandria area—15 cents a quart. During this same period, however, milk at stores was available to Washington consumers at 12 cents per single quart and two quarts for 23 cents, averaging 11½c per quart. Washington store prices were thus 3 to 3½ cents per quart lower than store prices fixed by the Richmond Milk Commission. . . . [Moreover] producer prices in both Washington and Arlington-Alexandria were set at the same level. . . ."[1]

It should be pointed out that farmers may be shortsighted in supporting milk-control legislation, since such laws bring about a higher level of prices for milk, which results in some shift in demand from fresh to canned milk and a consequent reduction in revenue since the product commands a lower price when sold in manufactured form rather than as whole milk. Those in the industry supporting such a system also fail to recognize the fact that if grocers are allowed to sell milk at a considerably lower price than home-delivery companies (even if grocers were to fail to recover all costs) those consumers not now able to buy milk might be able to purchase it, and others now buying might increase the amount taken. Price competition between different types of dealers very likely would force improvements in distribution efficiency also. It is said that milk consumption in the Boston area dropped 100,000 quarts a day when the 2-cent home-delivery–over-the-counter differential was reduced to 1 cent.[2] It was reported some time ago that in Portland, Oreg., Safeway Stores could sell milk for 9 cents and pay the farmer the full price and make money, but was forced by law to sell for 11 cents.[3] Safeway in December, 1948, took space in newspapers to inform the public of its desire to reduce the price of milk and the refusal of the Bureau of Milk Control to grant permission. Thus it appears that both the consumer and the more efficient producers may be adversely affected by milk-control legislation.

[1] BARTLETT, *op. cit.*, pp. 82–83.

[2] *Fortune*, *op. cit.*, p. 134.

[3] *Ibid.*, p. 136. It is said also that Safeway was embarrassed to find that it was making 35 per cent on its evaporated milk investment and 27 per cent on its milk and ice-cream investment, since the company boasts of being a low-cost mass-distributing organization which passes on savings to consumers.

Largely as a result of the depression, 26 states and the Federal government enacted legislation having to do with fixing consumer prices of milk between 1933 and 1940. It is encouraging to find that by the end of 1940, 8 of the 26 states (Delaware, Maryland, Michigan,[1] Ohio, South Dakota, Utah, Texas, and Washington) abandoned efforts along these lines, while the Federal government only attempted this type of regulation briefly. Since 1941 two other states (Indiana and Wisconsin) have discontinued this type of control, leaving 16 states now operating under milk price-control laws. Of these, New York and Connecticut have legislation applying only to producer prices; indeed, the New York law is not mandatory and the plan is in operation in only three markets. But many still remain in effect. These authors suggest that legislators in states having such laws review the operation of the milk-control agencies to discover whether they actually operate in the public interest as intended.

4. Price Control in Service Trades. Retail price control now has moved into certain of the service trades, where competition is likely to be sharpened when business activity declines. While not the only one, the barbers' field offers the best example of the technique employed in service enterprises in reducing the sharpness of competition by cooperative industry-government action. Such laws are in effect price-floor measures in the service fields and in some ways they are more drastic than those discussed thus far.

The California barber law, typical of others, is predicated upon the alleged relationship between public health and price, it being argued that if the price charged is inadequate, barbers cannot keep their equipment clean and themselves in good physical condition, either one of which is a menace to health—thus ignoring the fact that we have inspection laws and that antiseptic materials are very inexpensive. The law provides that on a petition of 75 per cent of the barbers in any community or county, the Barber Board (generally made up entirely of self-interested practicing barbers) may set minima below which no shop can go in pricing its wares. In setting the minima, the Board is required to consider (though not base its prices on, note) the necessary cost of keeping a shop in

[1] The Michigan act was invalidated in *Johnson v. Michigan Milk Marketing Board*, 295 N.W. 346 (1940), on the ground that the act required the appointment of a board (composed of two producers, one distributor, and one consumer in addition to the Commissioner of Agriculture) a majority of whose members had a direct pecuniary interest in the matters submitted to them, with the result that a petitioner could not obtain a fair hearing.

clean and sanitary condition. Some of the laws actually allow barbers to set a tentative price schedule by agreement, the terms of which are either confirmed or denied approval by the Board. Thus barbers set minima by legally sanctioned concerted action. However, the law further provides for review of the Board's decisions, without which provision certain laws have been struck down by the courts; and in some (though not all!) instances provision is made for revising barber prices downward in case it becomes necessary.

This type of legislation, upheld in some states where tested in the courts, but not in others,[1] is more drastic than Fair Trade or Unfair Practice acts in that these other types do not allow horizontal price activities on the part of members of the trade, while the barber laws (in some states at least) require it. But barber laws differ from the other types of price-floor measures more seriously, also, in that when competition is eliminated at the retail level in this field none remains, since in the service trades rivalry exists *only* at the retail level. Legislation of this kind has spread into the laundry and dry cleaning fields and will undoubtedly extend into other areas.

One very bad aspect of this type of legislation is the fact that the machinery provided for the setting of minima makes it possible for barbers to carry on extralegal activities. That is, since barbers are privileged by law to discuss minimum prices under the terms of these enactments, they may and do in many instances have formal agreements among themselves concerning actual prices. Thus prices charged consumers often are boosted way above the minima set. Actually, the legal minimum for haircuts in Los Angeles in July, 1946, was 65 cents, according to a survey made by the colleague of one of the authors. In October, 1945, the actual price charged by 65 per cent of the shops was $1. Some communities in California have now advanced to $1.25 for this seminecessity.

While an oligopolistic situation exists in the barber trade, and thus competition even when unrestrained would not be overly aggressive, barber laws combined with extralegal concerted activi-

[1] Thus barber laws have been upheld in *McRae et al. v. Robbins et al.*, 9 So. (2d) 284 (Fla. 1942); *Board of Barber Examiners of Louisiana v. Parker*, 182 So. 485 (La. 1938); *State v. McMasters*, 283 N.W. 767 (Minn. 1939); *Herrin et al. v. Arnold* 82 P. (2d) 977 (Okla. 1938); and others.

On the other hand this type of legislation was struck down in *Noble et al. v. Davis*, 161 S.W. (2d) 189 (Ark. 1942); *State Board of Barber Examiners v. Cloud et al.*, 44 N.E. (2d) 972 (Ind. 1942); *State v. Greeson et al.*, 124 S.W. (2d) 253 (Tenn. 1939); *State v. Neveau*, 294 N.W. 796 (Wis. 1940). In several states barber laws remain untested by the courts.

ties unquestionably raise the level of prices of the service offered by members of this trade above that which would exist otherwise. One reason for this is the fact that an individual may raise with the knowledge that his competitor is raising also, and therefore loss of volume due to a shift in patronage is minimized. Another is that activities of aggressively minded competitors, even though few in number, are circumscribed to a considerable degree by such legislation. Still, another reason is the fact that the move to a higher level is apt to be more prompt and a decline less prompt than when a free competitive system exists, since those who would raise prices have less to fear from the activities of "stragglers" and "unstable" competitors. Finally, while some differences in price still exist among shops even under barber laws, fewer alternative opportunities prevail for satisfying consumer requirements for barber service at lower prices because of mandatory oneness of action on the part of vendors at the minimum price level and a tendency toward concerted action at a somewhat higher level. Thus there is little question but that price competition is impaired, if not eliminated, where such laws are in effect.

Governmentally sanctioned concerted activities such as this might well have an adverse effect on the trade itself if those assuming leadership in price matters fail to follow an enlightened policy in this regard. Already the number of shaves sold by most shops in Los Angeles (typically at 75 cents!) has fallen off very drastically, although under present conditions most barbers do not seem to regret the loss of this business because of the fact that the volume on the higher priced haircut business is adequate at present. While the alternatives to paying excessive prices open to haircut customers are not as practicable as in shaves, opportunities of avoiding the full impact of enhanced prices do exist.[1] Thus monopoly power may be exerted to the serious disadvantage of those engaged in an industry.

As to the constitutionality of such legislation—earlier variations of the law, developing out of the emergency conditions of the great

[1] These are (1) shifting to smaller, out-of-the-way shops, which cannot exist very well without some price differential between the large, well-located shops and themselves; (2) visiting the barber less often, *i.e.*, going every three weeks, for example, instead of every two weeks; (3) organizing or participating in a consumer movement opposing high barber prices; (4) performing the service at home, reportedly quite practicable for those who wish to take the trouble (at this writing a Los Angeles cutlery firm is advertising barber clippers and shears in the *Times* for use in the home); (5) breaking with convention and affecting a style of wearing the hair long, as our forefathers did.

depression, were struck down when later considered by the courts. However, since the Nebbia decision, which indicated a change in the point of view of the United States Supreme Court on governmental price fixing when public health, safety, or welfare are involved, decisions by state supreme courts generally (though with some exceptions) have supported such enactments provided the laws have a genuine relationship to some legitimate purpose.[1] As was stated before, this type of legislation now has been extended to other trades also. For example, in Florida, Colorado, New Mexico, and Oklahoma similar legislation has been enacted covering the laundry and dry-cleaning fields; *e.g.*, a board is provided which acts on the prayer of those engaged in this trade from each locality to set up a schedule of prices below which no vendor may go.

As in the barber trade, aggressive price competition is practically eliminated with the extension of such legislation into these fields. There is no telling how far this movement may go; why should not associations of doctors, dentists, and accountants—and indeed druggists, grocers, or restaurateurs—set prices by concert of action? One of the most serious aspects of this trend is that legalized concerted pricing by members of the trade may become general practice. If so, one wonders where the consumer is supposed to fit into such a scheme. Therefore the trend, in our judgment, should be actively opposed by consumers as not in their interest. If it continues, they may have to organize and set up a *maximum* schedule of prices beyond which they will not go in buying the products or services of industries in which such pricing techniques are utilized. This would, indeed, fundamentally change our economic structure.

Questions

1. On the basis of a study of the actual laws in your state, explain the grounds upon which Fair Trade and Unfair Practice legislation have been declared constitutional. What is the difference in philosophy behind this type of legislation and orthodox antitrust laws?
2. Find out from your druggist the name of some branded item under Fair Trade and then compare the price of this item with that of a privately labeled competitive product.
3. On the basis of a study of pre-Fair-Trade law cases cited in this chapter and the provisions of the Tydings-Miller amendment, explain clearly the meaning of the statement that the latter partially vitiates the Sherman Act.
4. Explain why nationally advertised grocery items seldom are price-controlled under Fair Trade laws while nationally advertised drug items usually are.

[1] W. F. Brown and Ralph Cassady, Jr., "Guild Pricing in the Service Trades," *Quarterly J. of Econ.*, February, 1947, p. 318.

5. "Barber laws are even more drastic in their price fixing provisions than either Fair Trade or Unfair Practices legislation." Explain.

6. Should the milk industry be declared a public utility? Argue for or against this proposition. What major changes would be required in the legislation of states having milk-control laws to put public-utility regulation into effect?

7. The Department of Justice has cracked down on food and grocery bureaus acting in connection with the enforcement of Unfair Sales acts in several states. Why were these bureaus vulnerable to Federal antitrust laws when they were actually attempting to enforce a state price-control measure?

8. Analyze the nature of competition in the barber trade (numbers and types of competitors, buyer and seller information, ease of entrance into the field, possibilities of "product" differentiation, etc.) with the view of explaining why price control has developed in this field.

9. In what fields are Fair Trade laws found most? Why? How does it happen, in your opinion, that the use of this type of law is not as practicable in some other fields—*e.g.*, groceries?

10. In a radio advertisement recently the statement was made that while the prices of other products had increased greatly since 1940 (percentages were supplied), the prices of "fair traded" articles increased hardly at all (4%). Is this a recommendation for Fair Trade laws in your judgment? Why or why not?

11. The Federal government provides support for agricultural prices under its parity price scheme. Precisely how does this work? Would you place this type of arrangement in the same category as the other schemes discussed in this chapter, on the basis of social desirability? Why or why not?

CHAPTER XVII

INVESTMENT AND INSURANCE

Each family or individual usually needs to set aside a portion of income to provide for exceptionally large necessary expenditures, often unforeseen, encountered during the prospective earning life, and for an income during nonearning periods such as those due to unemployment, disability, or old age. In addition, in some instances an endeavor will be made to provide an estate of some sort for the present dependents or prospective heirs. There should be a definite plan carefully worked out and adjusted to the particular conditions. The nature of the plan, the amount to be accumulated, and the rate of accumulation will, of course, vary with the individual circumstances, and few generalizations can be made. The problem for an individual, for example, will be quite different from that of a family.

1. General Considerations. The consumer in saving is making an exchange of a portion of present purchasing power for a prospective future purchasing power. His first consideration naturally is that this purchasing power should be available to him at the time he wishes to use it. This necessitates a form of saving which is safe—*i.e.*, will return his principal to him—and is likewise readily marketable, so that he may secure a conversion into purchasing power at the desired time. A second consideration is that the exchange be made on as favorable terms as possible—that the future realized purchasing power be as great as possible. This means that the saving should be in such a form as promises to yield the largest return, from the viewpoint both of an increase in principal and of yield during the period of holding. The relative importance of these considerations varies with the purpose for which the saving takes place and the period of time under consideration.

A transfer of purchasing power over a considerable period of time must involve careful consideration of the device selected for the transfer. This is necessitated by the possibility of changes in the general level of prices. The transfers are of two general types. The first are those by which, in token of the present payment of dollars, promises of the return of specified sums in terms of dollars are

secured. An ordinary bank deposit is of this type; likewise the contracts sold by insurance companies and government and corporation bonds and mortgages. The simple hoarding of cash is of a similar kind. The other type of transfer is the purchase of property or a right to the share of the returns of income producers. Thus one might purchase a farm, or a house, or stocks of corporations. The significance of the distinction lies in the influence that the move-

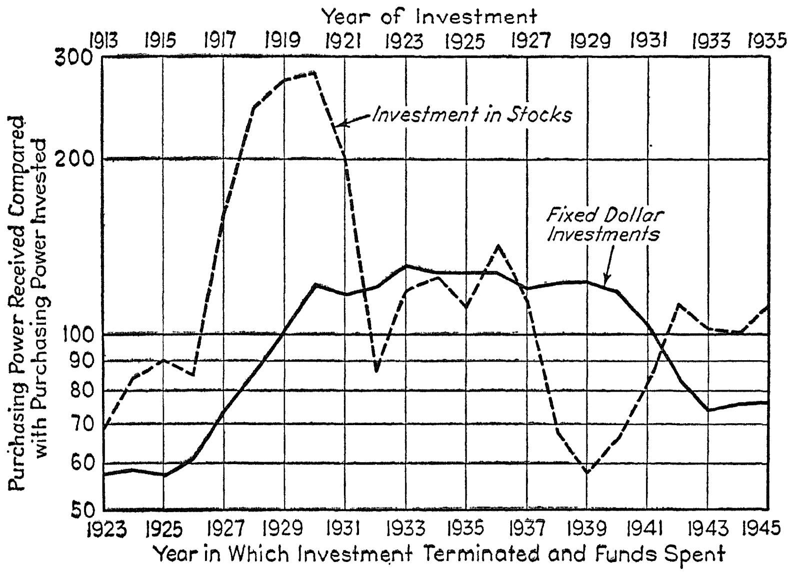

FIG. 15.

ments in the general price level exercise upon the prices of the two sorts of investments. The first sort, being promises to pay in dollars, remains unchanged or changes little in price, and in consequence the owner loses in purchasing power during a price rise and gains in purchasing power when prices fall. Where property or the rights to the returns of income producers are held, however, both the returns and the values would be expected to rise with an increase in prices and to decline as prices fall, thus tending to maintain purchasing power.

If it were possible to foretell the movement of the general price level, the proper policy to be followed by the consumer would be clear. In periods of falling prices, the holdings would be promises to pay in terms of dollars, since these would increase his purchasing power with each decline in price. In periods of rising prices, prop-

erty, which will increase in price, should be held so that purchasing power will be maintained or possibly increased. The amount of purchasing power which consumers would have from investments of these two types made ten years earlier are shown in Fig. 15 for particular years in the period from 1923 to 1945. The property investment has been represented by an index of common-stock prices. The fixed dollar investments show a decrease in purchasing power in 10 of the 23 years, while the common stocks show a decrease in 9 of the years. The wide swings are sufficient to indicate the nature of the investment problem. Neither type of investment is likely to return the amount of purchasing power set aside. The difficulty with varying the investment policy of the individual between these two types of investments lies in the virtual impossibility of forecasting movements in prices. Even the best-qualified technical experts have been wrong in their forecasts nearly as often as they have been right, and the ordinary man will find himself mistaken on a number of occasions. This suggests that the proper policy for an individual would be to have investments of both types. The general balance might be shifted as one thought one foresaw a general price movement in a particular direction.

2. Investments Yielding Fixed Dollar Returns. There are a wide variety of opportunities for the investment of funds in institutions or securities promising fixed dollar returns. The more important of these are the savings banks, or savings departments of commercial banks, the postal savings system, credit unions, and savings and loan associations. Practically all of these operate under supervision of various Federal and state authorities. In addition there are available mortgages, corporation and government bonds, and annuities or endowments sold by insurance companies. Safety of principal is readily secured in this field of investment with a moderate exercise of judgment by the investor, although interest returns tend to be low and the purchaser is exposed to changes in the purchasing power of the investment due to changes in the prices of consumer goods.

Two sorts of savings deposits in banks are possible, those in a savings bank and a savings account in a commercial bank. Savings banks are found in 18 states. They differ from ordinary banks in the special regulation of their investments. In New York, for example, the law prohibits savings banks from investing in stocks of any kind, in foreign securities of any nature, and in corporate securities other than steam-railroad and public-utility enterprises.

The results of these restrictions have been to strengthen the banks and curtail losses from failures. Mutual or trustee savings banks are found mainly in New England and the Eastern states. The mutual or trustee savings bank does not possess any capital stock. The depositors are the mutual owners of the bank. All the earnings of the bank, less administrative expenses and apportionment to the guarantee fund or surplus, are divided among the depositors in the form of interest. The funds of the institution are derived solely from the deposits. The institution is managed by a body of non-depositing trustees. They usually hold office for life and are generally prominent businessmen who render this service as a public duty. There are about 560 of these institutions in the United States with total deposits of over 10 billion dollars. The stock savings banks are primarily a Middle West institution. They differ from mutual savings banks only in their ownership. The stock bank usually pays its depositors a stipulated rate of interest, and the profits, if any, accrue to the stockholders. The stockholders at times have a double liability for their stock; *i.e.*, they may be called upon to furnish an additional amount equal to their stockholdings in case the bank encounters difficulties.

Many commercial banks maintain separate savings departments. It is also evident that, in the 30 states that do not have savings banks, depositors are obliged to open an account in a commercial bank if they desire to keep their funds in a banking institution. The Federal Reserve Bank and the banking departments of the various states require a separate accounting of these deposits, and the reserve requirements and investments of this portion of the funds are regulated. The assets of the bank, however, are the common property of all depositors, whether in savings or in checking accounts, and, since savings banking is ordinarily less risky than commercial banking, there would be less risk with funds in a regular savings bank than with funds in the savings department of a commercial bank. The element of risk has been greatly reduced in those commercial banks in which deposits are insured with the Federal Deposit Insurance Corporation. This insures deposits up to a maximum of $5,000 in each account.

The Federal government now provides through the U.S. Post Office Department a savings institution operated by the United States government. Any person ten years of age or over may open a postal savings account at any post office authorized to accept deposits. A person not near such an authorized post office may

open an account at any depository office by mail. The deposits are acknowledged by postal savings certificates of $1, $2, $5, $10, $20, $50, $100, and $500. These certificates are nontransferable and nonnegotiable. Interest is credited at the rate of 2 per cent annually. There is a maximum of $2,500 on the amount that any depositor may have to his credit, exclusive of accumulated interest. Withdrawal of all or any part of the deposits may be made by the depositor at any time from the post office where the deposits were made. Amounts less than $1 may be saved by the purchase of postal savings stamps at 10 cents each. Postal savings cards with 10 savings stamps affixed are accepted as a deposit of $1. The postal savings system has never occupied a large place in American finance. On June 30, 1948, deposits totaled $3,378,000,000.

The United States government also offers through the post offices United States savings bonds which are a direct obligation of the Federal government. The bonds, maturity values are $25, $50, $100, $500, and $1,000. Series E bonds are sold on a discount basis whereby the interest accumulates during the lifetime of the bond and the maturity value includes both principal and interest accumulated over a period of 10 years to maturity. The issue prices are $18.75, $37.50, $75, $375, and $750, which would yield an annual interest of about 2.9 per cent. These bonds are nontransferable. They may be redeemed at any time subsequent to 60 days after issue at stipulated prices rising according to the period for which the bond has been held. In event of redemption before maturity, the realized rate is less than 2.9 per cent. These bonds are an unusually attractive investment for those who desire a maximum of safety and convenience on their savings and who do not require any income return during the life of the bond. In 1949, there were about 32 billion dollars in bonds outstanding.

Another popular form of savings in the United States is provided by the purchase of shares in savings and loan associations. These associations are mutual organizations designed for long-term savings. Previous to 1933, these associations were chartered by the states, but legislation enacted in that year authorized the granting of Federal charters. Both Federal and state institutions are now found in the field. Investment is made through the purchase of shares, ordinarily with a par value of $100. The shares usually are bought by regular monthly payments at the rate of 50 cents per share. Dividends are paid proportionate to the amount paid in. Full payment for the shares usually requires about 12 years, when the divi-

dends are around 4 per cent. Other methods of purchase less frequently used include irregular payments in amounts of $1 or more, prepayment of a considerable portion of the share, and purchase of fully paid shares through a single payment of the full stated value of the share. The funds of the associations are invested almost exclusively in first mortgages on owner-occupied small homes. In consequence, the associations are known in many sections of the country as building and loan associations. Associations meeting Federal specifications may secure insurance on accounts up to a maximum of $5,000 for each person in the association. There are said to be nearly 10 million personal accounts in the associations in this country, and the total assets of the associations aggregate about 7 billion dollars.

The differential in interest (or dividends) between savings banks and building and loan associations often is an important consideration for the consumer. In some districts, for example, savings banks pay only 2 per cent while building and loan associations pay 4 per cent. There are at least two reasons for this: (1) Savings banks invest to a great extent in unusually safe securities, but building and loan associations invest largely in mortgages. Theoretically, at least, the former offer a greater safety factor. (2) Savings banks ordinarily offer a greater amount of service; *i.e.*, savings deposits may actually be withdrawn without notice (though legally the banks may require notice). Building and loan associations (perhaps owing to the nature of their investments) often cannot be so prompt in this respect. As has been mentioned, however, depositors (or shareholders) in each are insured by a Federal government corporation. Hence each is considered quite safe as an institution for accumulating funds.

Mortgages on both farm and city property may also often be advantageously used as investments. They have the advantage of calling for a definite amount to be paid both in interest and in principal. They have the disadvantage that the appraisal of the property securing them may be incorrectly made, that they usually can be sold at a forced sale only at a large discount, and that, in case of default of payments, foreclosure is costly and may result in a loss. They generally yield a higher return than bonds. Though mortgages are used extensively by insurance companies as an investment, this does not mean that they prove good investments for the small investor. The fact is that there are great differences between individual mortgages, hence they require too technical a knowledge

of property values to be purchased without the advice of competent disinterested parties.

Under certain circumstances, purchases of annuities or pure endowments from insurance companies may be advantageous. These have been considered at some length under the discussion of insurance.

3. Investments in Property. Instead of investing in contracts which call for specified returns in dollars, the investor may purchase something expected to change in price. This will usually be the purchase of real estate, or a share in or all of a business enterprise. The returns from such investments will depend upon the earnings of the enterprise or the property. Wisely chosen, such investments may yield large returns. It is significant for the ordinary investor that when there is a general rise or fall in prices and business activity, the incomes from these investments tend to fluctuate in the same direction. This will in part or perhaps more than offset the changes in the cost of living. The difficulties are that investments of this type require a great deal of judgment and an intimate knowledge of the particular property or enterprise, and usually the ordinary investor does not possess this technical knowledge.

The advantage of investments in contracts which call for returns in dollars is that with the exercise of a moderate discretion the investor may be fairly certain to secure the return of his principal and a low but sure interest return. The danger of a price rise that would lessen the purchasing power of his savings is always present and, although his first investments should be primarily of this type, after some accumulation he should consider purchases of income property or rights to the earnings of property, as a hedge against such a price rise. In case the income of the family is derived from the ownership of a business, then this type of hedge will be amply provided by the opportunities for reinvestment in the business. The more usual consideration will be the question of purchasing a home or buying stocks in some company.

Renting is usually less expensive than home ownership if full allowance is made for all costs. Home ownership, however, often provides a psychic return to the family in excess of that derived from renting. Home ownership is also entitled to consideration on the grounds of the probable appreciation in value of the property with a price rise. The purchase of a home requires such a large investment or commitment to make certain payments that utmost consideration must be given not only to the probable value of the

property itself but also to the size of the total investment. The purchase price should not exceed two or at the most two and one-half times the annual income of the family; otherwise the burden of ownership will become excessive. The ordinary family will rarely make an investment of this size in any other way during its life. For this reason, the most careful consideration will need to be given to it.[1]

Informed observers are practically unanimous that stock speculation is an "unbeatable game." Probably not one out of a hundred who "play the market" is eventually successful. This does not mean, however, that a portion of the small investor's holdings may not be held properly in the form of shares in carefully selected corporations. These stocks should be purchased only after examination of the reports of some reliable, disinterested rating service such as Moody's Investment Service or Standard Statistics; should be securities listed on one of the larger stock exchanges; and should be purchased outright.[2] The unit of trading for stocks on the New York Stock Exchange is 100 shares. Lots smaller than this are known as *odd lots* and comprise 30 to 40 per cent of all the trading. Certain traders on the exchange specialize in handling these odd lots and handle shares at a differential of from one-eighth to one-fourth of a point, depending upon the marketability of the stock, charging a higher price if buying and remitting a lower price if selling. The investor may thus purchase as little as a single share in the largest corporation.

The purchaser of stocks has secured some safeguards through the Securities Exchange Act of 1934. This law provides that all important stock exchanges shall be registered with the SEC as national security exchanges. The registered exchanges become subject to Federal rules and regulations, and the individual securities

[1] For an excellent discussion of the considerations to be taken into account when faced with the problem of whether to rent, buy, or build a home, see the article by Albert Mayer on this subject in Consumers' Union Reports, Jan., 1938, pp. 7–11. The same issue of the Reports announces additional future articles on the community, on the site, orientation and plan of the house, on furnishability and style, on various types of materials, and on the maintenance of the home.

[2] David F. Jordan ("Managing Personal Finance") lists the following as 10 high-grade stocks: American Telephone and Telegraph, E. I. du Pont, Eastman Kodak, General Electric, General Motors, International Harvester, Pacific Gas and Electric, Pennsylvania Railroad, Standard Oil of New Jersey, and Union Pacific Railroad.

listed on these exchanges likewise must be registered. The public must have made available to it accurate and complete current information with respect to those securities. Speculative manipulation of security prices is forbidden. These advances in the protection of the security purchaser have been highly desirable, but the individual should not rely upon the law to protect him; he must continue to exercise good judgment in his selection and be wary of fraud.

4. Insurance. Mankind is exposed to the possibility of many serious losses, such as those resulting from physical or mental disability or premature death. In the case of an individual, the exact time when such loss may occur is impossible to foretell. On the other hand, when a large group is considered, it becomes quite possible to foretell fairly accurately the happenings within the group. Thus the possible life span of a man thirty years of age is extremely uncertain; but if 100,000 men at age thirty in sound health are taken, it is quite possible to determine from statistical data with a very small degree of error the number who will die each year. Although premature death or disability itself cannot be allocated or dealt with financially by the individual, the consequences of such hazard can be distributed over a large group of individuals by a system of individual contributions, the total of which, being scientifically calculated, is sufficient to reimburse the individual for the financial hazard to him. This is the so-called *spread of risk*.

The standard device used in this country for calculating the probability of death is the American Experience Table of Mortality.[1] Starting with 100,000 persons at age ten, it gives the number living and dying during each succeeding year. The table was compiled nearly 70 years ago and is very liberal in that fewer die than the table indicates. Since it errs on the conservative side, it has been retained as the basis of estimate. Large companies will seldom have an actual mortality experience as high as that indicated by the table. The following table shows the data for the first 2 years and by 10-year periods.

Expectation of life means the number of years, on the average, that those living at a particular age may be expected to continue to live. It is the sum of the additional years each person lives divided by the number of living at the age taken.

[1] Newer and more accurate mortality tables are now coming into use. These tables take account of the changed mortality at different ages from those in the American Experience Table. Insurance rates are changed somewhat for the various age groups but the general principles remain the same.

Data of this character enable the insurance company to write a great variety of contracts. There are three basic types of contracts which may be combined or varied in the type of policy sold by the insurance company. The basic types are *life insurance*, *annuities*, and *endowments*. From the standpoint of the individual, the *insurance* contract consists of an agreement with the company whereby the latter agrees to pay a designated party, the beneficiary, a stipulated sum upon the happening of the specified event. In

TABLE 60. AMERICAN EXPERIENCE TABLE OF MORTALITY

Age	Number living	Number dying	Expectation of life
10	100,000	749	48.72
11	99,251	746	48.08
20	92,637	723	42.20
30	85,441	720	35.33
40	78,106	765	28.18
50	69,804	962	20.91
60	57,917	1,546	14.10
70	38,569	2,391	8.48
80	14,474	2,091	4.39
90	847	395	1.42

return for this agreement the insured contracts to pay certain sums, called *premiums*, at specified times. In the case of an annuity, the company in return for the payment of a specified sum agrees to pay the annuitant a certain annual payment for the remainder of his or her life. A pure *endowment* is a contract in which the company in return for the payment of certain specified sums agrees to pay the designated party a certain amount if he is living at a specified time. Let us now return to an examination of the mortality table and see how it aids in determining the costs of the various contracts.

Assume that we were to insure 100,000 persons at age 10 for 1 year only, for $1,000 each. The table states that we may expect 749 of the 100,000 to die. We would thus expect to pay $749,000 to the beneficiaries of those who died. If each of the insured had paid $7.49 we would have had the required amount to pay these beneficiaries. Now let us suppose that we had insured the original group for 2 years instead of 1. During this period 749 would be expected to die the first year and 746 the second year, according to our table. Had we collected $14.95 from each of the insured at

the beginning of the period we would have had the required amount to make the payments to the beneficiaries. If we had collected an annual premium at the beginning of each year, then a premium of about $7.50 a year would have been sufficient. Such insurance would have been *term insurance* since it applied only to a 1- or a 2-year period.

There is a great variety of term contracts. The simplest, and supposedly least expensive, is the *yearly renewal term*, renewable to a certain age, as 55, 60, or 65. The premium for this contract steps up yearly. Then there is the 5- or 10-year *renewable and convertible* term. The premium for this contract steps up every 5 or 10 years and may sometimes be renewed to sixty or sixty-five without evidence of insurability. The regular 1-2-3-5-10-20-year term and the term to 50, 60, 65, or 70 are some of the many forms of term contracts. Almost without exception, any term contract may be converted to a higher premium contract without evidence of insurability at either original age of issue or at attained age. It must be remembered that the term contracts provide insurance for a stated period only, at the end of which period the policy expires and the obligation of the company is canceled. No portion of the premium is set aside in a savings or a sinking fund; the premium paid represents the cost of the protection.

Policies may be written for the entire life of a person as well as for a specified period of time. Such a contract is known as a whole life policy. The premium outlay for these contracts varies with the age of the insured. The funds that are to be paid must be obtained from the group, and the probable period over which premiums can be collected is indicated by the expectation of life. Thus for a group issued ordinary life insurance at age 30, the average expectation of life is 35.33 years, and this is the average number of years over which it may be expected that premiums will be collected. If the age of persons on whom the insurance was issued was 40, then the average number of years over which it may be expected that premiums will be paid would be 28.18 years and the annual premiums would need to be enough higher so that the required sums could be accumulated in a shorter period. The premium for ordinary life insurance will thus rise with the age at which the policy is originally taken out.

Whole life policies are customarily written upon a level-premium basis. This means that the annual premiums remain the same throughout the lifetime of the insured rather than rising year by

year as the probability of death increases. The level-premium plan involves charging during the early years of the policy a net premium which is larger than is necessary to pay for the insurance in those years, with the result that a fund is accumulated to meet the costs of the insurance incurred in the later years. An example is shown in Table 61.

TABLE 61. PREMIUMS, RESERVES, AND AMOUNT AT RISK FOR $1,000 WHOLE LIFE POLICY AT AGE 35*

Attained age at beginning of year	Annual net level premium	Annual cost of $1,000 insurance for the year	Tabular cost of insurance for amount at risk	Reserve at end of year	Amount at risk	Sum of reserve and amount at risk
35	$21.08	$8.95	$8.84	$12.88	$987.12	$1,000
39	21.08	9.59	8.94	68.16	931.84	1,000
44	21.08	10.83	9.25	146.01	853.99	1,000
49	21.08	13.11	10.05	233.28	766.72	1,000
54	21.08	17.40	11.70	327.58	672.42	1,000
59	21.08	24.72	14.20	425.49	574.51	1,000
64	21.08	36.87	17.59	522.92	477.08	1,000
69	21.08	56.76	21.85	615.14	384.86	1,000
74	21.08	87.03	26.27	698.21	301.79	1,000
79	21.08	131.73	29.73	774.29	225.71	1,000
84	21.08	211.36	32.97	844.01	155.99	1,000
89	21.08	395.86	37.37	905.59	94.41	1,000
94	21.08	857.14	43.04	949.79	50.21	1,000

* TNEC Monograph No. 28, "Study of Legal Reserve Life Insurance Companies," p. 180.

There are thus two elements that make up the amount that is paid the beneficiary on the death of insured, namely insurance and savings. These parts vary in importance depending upon the number of years during which the policy has been in force. The reserves are the source of the cash surrender values and loan values now a feature of practically all life policies, except term policies, written by legal reserve companies. An example is given in Table 62.

Three methods of payment of the surrender value are generally provided: cash settlement, paid-up insurance, and extended insurance. Under a cash settlement, no insurance remains in force. Under extended insurance, the policy remains in force for a limited period of time, and under the paid-up life insurance settlement, the face of the policy is reduced and the policy remains in force throughout the life of the insured. Under both of the latter settlements the

amount of the insurance secured is the amount that the cash surrender value will purchase as a single net premium. The loan values represent the amounts which the company will loan to the insured on the security of the policy. The loan values are generally equal to the cash surrender value of the policy.

An annuity is a contract in which the company agrees to pay the annuitant a specified sum periodically as long as he or she is alive. The period over which these sums are paid for a group will naturally

TABLE 62. GUARANTEED VALUES OF AN ORDINARY $1,000 LIFE POLICY TAKEN OUT AT AGE 25

Years policy has been in force	Cash surrender value	Paid up life insurance	Extended insurance	
			Years	Days
2	$12	$34	1	214
3	26	71	3	159
4	36	95	4	249
5	45	119	5	355
6	55	142	7	111
20	230	457	19	166

depend upon the average expectation of life of the group. The investment of a given sum in an annuity will thus yield a larger income to the annuitant the older the age at which the annuity begins. For those who are well along in years and have no posterity to consider, the annuity is a valuable means of securing them the largest possible certain dollar income for their entire life. The interest rate at which insurance companies figure earnings is low, and in consequence for young people annuities do not yield more than could be earned by other investments. For older people the rate becomes high, passing 8 per cent sometime between ages 50 and 60. Table 63 shows the average annuity returns for 15 American companies for males of various ages.

A pure endowment is a contract with the insurance company by which in return for the payment of specified premiums it agrees to pay the insured a certain sum if he is alive at a given time. Endowments are generally for a stated number of years; thus a 20-year pure endowment is an agreement to pay the specified person the amount of the endowment if he is alive at the end of the 20-year period. If he should die or the specified payments are not made during the period, the company retains the payments already made to provide a portion of the funds to be paid those entitled to receive payments

at the end of the period. The cost of a pure endowment will decline as the age increases since there will be a greater probability of death within the specified period in the case of older persons.

Pure endowments are seldom purchased except in special circumstances. Among these is, however, the building of an education fund for children. In combination with term insurance, however, pure endowments become the familiar endowment insurance policy. Thus a 20-year endowment insurance policy provides insurance for

TABLE 63. AVERAGE OF THE RETURNS YIELDED BY ANNUITIES TAKEN AT VARIOUS AGES IN 15 AMERICAN COMPANIES*

Age	Per Cent Yielded by Annuity
40	5.83
50	7.03
60	9.21
70	13.27
80	19.35

* C. O. HARDY, "Risk and Risk Bearing," p. 278.

the beneficiary for a 20-year period, and if the insured is alive at the end of the period, provides him with a sum equal to the face of the policy.

Contracts differ in their manner of premium payment. Each may be purchased by the payment of a lump sum at the beginning or by periodical deposits such as annual, semiannual, quarterly, or monthly payments. Immediate annuities are always purchased by a lump-sum payment at the beginning of the contract. Many deferred annuities and some life and endowment insurance are purchased by this single-deposit plan. However, the bulk of insurance is bought on the installment plan.

Policies differ as to the number of persons they insure. Insurance policies are commonly written on the life of a single individual, but occasionally joint life policies are written, which cover the lives of two or more persons and are payable upon the death of the first. Insurance is also written upon larger groups and is known as *group insurance.* Group policies differ from joint life policies in that they are not terminated by the death of one of the individuals. Employers often secure blanket insurance against the death of their employees, payable to the families of these employees upon their death. Such policies are called *group insurance policies.* The cost of this type of insurance is borne either by the employer alone or by equal or unequal contributions by both employer and employee. They are

not written on specific individuals but on all who are employed by this particular employer, and often only during their period of employment.

The great bulk of the insurance written in this country is written on a legal-reserve basis, although there is some provided by fraternal or assessment associations. Roughly, insurance companies fall into two groups, known as *stock* and *mutual* companies. The volume of business done by mutual companies is in excess of that of the stock companies, although the latter exceed the mutual companies in number. Mutual companies are, as the title suggests, owned and controlled by the policyholders, whereas stock companies are, of course, owned and controlled by the stockholders. Policies vary according to the right they convey to share in the profits of the company. *Participating* policies provide for the return to the insured of a portion of his premium, known as a *dividend,* in the event that the earnings of the company justify such a dividend. The term *nonparticipating* applied to policies simply means that the profits accruing are paid not to the policyholder but to the stockholder in the stock company.

The premium which is paid to the insurance company is composed of two parts. These are the natural premium and loading. The natural premium is the estimated mortality cost and the reserve. Loading is the amount which is added to the natural premium for the expenses of operating the company, including the cost of selling the policy. Profits may arise from overstatement of mortality cost. The American Experience Table overstates the probability of death at the present time, and most companies have an actual mortality rate considerably below that used in their calculations. Savings may also arise from overloading, since the costs of company operation may have been overestimated. The principal source of profits in the past, however, has been the ability of the companies to earn a higher rate of interest on their investments than that used in their calculations on insurance and the reserves. Lower rates of interest upon investments in recent years have greatly curtailed the earnings of the companies from this latter source and have forced a reduction in dividends. Through the 1920's and 1930's dividends in many instances approximated a third of the premiums paid.

Insurance policies differ in their premium outlay depending upon the nature of the policy. Premiums vary with the age of the insured. The higher ages have greater risks of death than the lower ages, and in consequence, for a given type of policy, the premium rates

increase with the age at which the insurance is taken out. The most inexpensive policy, from the standpoint of the annual outlay required, is the term policy, and the shorter the term, the lower the annual premium. Straight life will cost more than term insurance. Limited payment will necessitate a larger premium than straight life, because the period during which the fund to pay the insurance is accumulated is limited, rather than extending over the entire life. Premiums for endowment insurance will be much higher than those of the preceding types, since, in addition to the insurance provided,

TABLE 64. ANNUAL COST OF $1,000 OF INSURANCE

Type of insurance	Age when insured	
	25	45
5-year term	$9.68	$14.82
Ordinary life	20.14	37.09
20-payment life	30.07	45.69
20-year endowment	48.03	54.15

a fund equal to the face of the policy must be built up during the policy life to provide the endowment at the end of the period. Other types of policies will vary in cost depending upon their particular features. An example of the quoted rates is given in Table 64. These are to be taken only as indications, and some differences will be found among companies. Comparison among companies is usually made on the basis of net cost upon surrender, *i.e.*, on the basis of the total premium minus total dividends minus surrender value, and the company showing a low net cost is usually considered the better company, other things being equal. The purchaser of insurance should always keep in mind that he is buying a contract. Instead of buying by net cost upon surrender only, he might examine the provisions in the contract upon which such cost is based. There is not much difference between the best companies with regard to net cost, but there is a great difference between the best and the worst.

Two principal problems confront the purchaser of insurance: the choice of a type of policy and the choice of a company. Choice of the type of policy depends upon the individual situation, and few generalizations can be made. It usually is a question of the proportion to be directed toward insurance and toward accumulation. As indicated in Table 65, the same expenditures may be divided between

insurance coverage and accumulation in varying degrees. If the primary consideration is insurance, as is usually the case with younger family groups, some form of term contract should often be recommended to give the family as much protection as possible for the minimum premium outlay. As soon as the family can afford a reasonable amount of protection and in addition to protection can set aside a small investment fund, then the ordinary life contract is to be recommended.

TABLE 65. AMOUNT PURCHASED WITH AN ANNUAL GROSS PREMIUM OF $300 IN A LARGE MUTUAL COMPANY AT AGE 25*

Type of policy	Premium per $1,000	Insurance	Cash surrender value			
			5 years	10 years	15 years	20 years
Ordinary life.......	$20.14	$14,895	$681	$1,474	$2,389	$3,434
20-payment life....	30.07	9,977	953	2,085	3,431	5,034
20-year endowment.	48.03	6,246	1,158	2,548	4,219	6,246

* The cost less dividends, based on past experience, would have been almost two-thirds of these figures.

The choice of the best company requires analysis beyond the resources of the ordinary insurance purchaser. The fairly simple advice which may be followed in the selection of the insurance company is (1) that it should be large, (2) that it should be old, and (3) that it should be a mutual company. Size of company is desirable for an ample spreading of risks of the various contracts and among different age groups. There are good small companies as well as poor ones, just as there may be differences among the large companies, but the chances of picking a poor company among the large are less than among the small. If the company has been operating for many years it will have established its probable ability to continue operations. If it is a mutual company the earnings, if any, will accrue to the policyholders.

Two principal classes of insurance are purchased by individuals from insurance companies. These are usually designated as ordinary and industrial insurance. The ordinary insurance policy is customarily written in units of $1,000 and the premiums are payable annually, semiannually, or quarterly. The industrial policy, which is primarily sold to persons in the lower income brackets, is for smaller amounts and weekly premiums are ordinarily collected by house-to-house agents who call at the homes of the policyholders.

Industrial insurance customarily includes as an integral part of the contract the double indemnity clause, a provision doubling the benefit in case death occurs from accidental causes. It also includes a clause waiving the payment of premiums in the case of total and permanent disability to the insured. These provisions are also available in ordinary insurance policies, but usually only upon the payment of an extra premium. Because of its manner of sale, industrial insurance is more expensive than ordinary insurance and is not to be recommended when ordinary insurance can be purchased.[1]

5. Borrowing by Consumers. There are occasions upon which it is necessary for the family to borrow money. If there are life insurance policies the loan values of these may provide the funds, or if the family is well established in the community a loan may be secured from a commercial bank. More frequently, however, the borrower must turn to personal lenders. Such loans are regarded as poor risks by the lender, involve considerable administrative expense, and in consequence carry high rates of interest. Borrowings may turn out to be very expensive from the viewpoint of the borrower.

The principal institutions lending to small borrowers are: (1) personal finance companies, (2) industrial banks, (3) personal loan departments of commercial banks, and (4) credit unions. The personal finance companies operate under license in the states in which small-loan laws have been enacted. These laws generally permit the lenders to charge as much as 3½ per cent *monthly* on unpaid balances, which is at a rate of 42 per cent annually, on loans of $300 or less. Legislative attempts to reduce the high cost of personal loans by the enactment of low maximum rates have tended to be detrimental by driving out legitimate lenders and forcing the borrowers to pay higher rates to unlicensed lenders, the so-called "loan sharks." Most of the loans made by personal finance companies will be secured by a chattel mortgage, probably on the furniture owned by the family. A typical loan would be for $150 payable at $7.50 a month over a period of 20 months, with interest on the unpaid balance at 3 per cent per month.

The industrial banks also operate under special legislation. The leading companies in the field are the Morris Plan banks, of which

[1] TNEC Monograph No. 28, "Study of Legal Reserve Life Insurance Companies," on p. 286 compares the 10-year net cost in the same company of whole life policies of these two types. The net cost of the industrial insurance was $243.72 and that of the ordinary insurance was $152.39.

over 100 are in operation in various parts of the United States. The typical loan here would be for $200 under a 1-year installment repayment contract signed by the borrower and two co-makers who guarantee payment. The borrower is charged an investigation fee and interest is deducted in advance.

Many large city banks now have special departments making small personal loans. These departments operate under the general banking laws rather than the small-loan laws. They are limited to the interest rates charged on their regular loans, but by collecting interest in advance, imposing investigation fees and fines for late payments, the rate actually paid by the borrower is higher. These departments, where available, frequently provide one of the most economical sources of loans to the small borrower.

Credit unions are cooperative associations, usually formed by a group having some common interest such as employment in a large company, membership in a church, or location in a farming community. Each member subscribes for at least one share, the usual par value being $5 with payment in installments, often as low as 10 cents a week. Funds are loaned to members on applications approved by the loan committee. On loans up to $50 no security is required, but on loans exceeding $50 and up to the maximum of $200, endorsement of co-makers is required. Credit unions serve not only to promote thrift among their members, but also provide credit facilities at a cost below that of other lending institutions in the personal loan field.

In addition to the agencies already mentioned, there are in some cities "remedial loan societies" (of a semicharitable nature), pawnbrokers, and unlicensed lenders. These are likely to be patronized by the more unfortunate who do not have access to the other institutions.

Questions

1. In view of the possibility of a rise in the general price level and the growing feeling of social responsibility for the aged, do you think that young people are justified in making any serious attempt at substantial saving?
2. What influence would changes in prices have upon the value of an annuity?
3. If a person should decide to cash in or surrender his insurance policy, what alternatives would be open to him?
4. What bearing do the earnings of a company have on the probable relationship of the price of its preferred and common stock?
5. If you should inherit $10,000, how would you invest it at the present time? Justify your answer.
6. At what period of the business cycle would you advise the purchase of stocks and at what period bonds?

CHAPTER XVIII

THE PROBLEM OF PURCHASING CONSUMERS' GOODS

The division of income among the budget groups and the decision as to the direction and kinds of expenditures do not complete the problem of the administration of that income. Commodity selection is essential to the complete consumption cycle since scales of living may be impaired by a dissipation of money income resulting from unintelligent consumer buying, a condition which becomes increasingly acute when inflationary trends set in. In the case of purchases, the problems of where, when, how much, and what to buy becomes very important. There is, in addition, the question as to what method one should select in paying for the goods. All these are important consumer problems. Each becomes more complex as the variety of products increases and as conflicting claims continue to be made regarding commodities and the several channels of distribution.

There is without question tremendous effort expended by business to persuade consumers to purchase higher quality merchandise than they require; to buy on the bases of fear, pride, and snobbery as substitutes for rational judgment; to utilize certain service features —*e.g.*, installment contracts—which, in many instances, are extravagant and wasteful. It is the opinion of the authors that the efficiency of consumer purchasing could be increased materially if a sort of skepticism could be created in the mind of each buyer. The consumer, in other words, should avoid the acceptance of vendor claims without careful investigation. An experimental attitude on the part of the buyer will lead toward a more careful selection of goods and services. Wherever possible, information derived from dispassionate investigation should be substituted for biased claims of producers.

1. The Amount of Purchasing by Women. The problem of buying falls principally upon the housewife. In the majority of homes, fully two-thirds of the purchases made will be at her direction or with her advice. Articles entering directly into the consumption of other members of the family are often purchased by the housewife—*e.g.*, the shirts and ties of many a husband. We may gain

some idea of her importance from Table 66, which shows the percentage of different articles purchased by various members of a group of New York families.[1]

TABLE 66. A COMPARISON OF THE PROPORTION OF THE PURCHASES OF CERTAIN ARTICLES MADE BY MEN AND WOMEN*

Class of article	Percentage by men all alone	Percentage by women all alone	Percentage by both	Percentage by neither
Men's clothing	65	11	23	1
Women's clothing	1	87	12	0
Druggist's articles	10	48	41	1
Kitchenware	2	89	8	1
Pets	19	5	15	61
Dry goods	0	96	4	0
Vehicles	23	1	15	61
Housefurnishings	4	48	46	2
Musical instruments	13	7	20	60
Raw and market foods	0	87	13	0
Package foods	3	79	14	4
Miscellaneous	6	22	68	4
Average	12.2	48.3	23.2	16.2

* H. C. HOLLINGWORTH, "Advertising and Selling," p. 296.

2. The Problem of Where to Buy. Identical goods are often sold at different prices in the stores of the same community. These differences are quite substantial in many instances. They are likely to be more pronounced in convenience than in shopping goods, and,

[1] That the head of the family has a great deal of influence in most of the consumer purchasing, however, there is little doubt. The following excerpt from an advertisement designed for the purpose of selling advertising space in *Time* magazine, though humorous and somewhat biased, illustrates the importance of men's influence in purchasing: ". . . shrewd advertising men know that he who talks only to the woman is only half doing his selling job . . . let the men who read this ponder well whether Woman (the natural purchasing agent to be sure) really *determines* the purchase of 85% of everything which goes into the home . . .

"When the wife of a business man—*your* wife, for instance, wants an automatic refrigerator does she just trip out and pay $400 for the best looking one? Or do you first authorize the expenditure, and secondly, look into the mechanics and upkeep of the different makes yourself? . . .

"When a roof leak is discovered, does your wife call in a contractor, on her own and tell him to put on asbestos shingles? Very seldom, very seldom. Isn't she actually a passive buyer of oil burners or furnaces, of lumber, stone,

in consequence, while the difference on a particular purchase may be small, the total saving, if all items were purchased at the lowest possible prices, would be quite significant. Table 67 gives figures for comparative prices between independent and chain drug and grocery stores.

TABLE 67. RELATIVE CHAIN AND INDEPENDENT SELLING PRICES AS REVEALED BY THE FEDERAL TRADE COMMISSION CHAIN-STORE INVESTIGATION*

City	Year	Selling prices	
		Independent	Chain
Part A: Grocery Study			
Washington	1929	106.42	100
Cincinnati	1929	108 84	100
Memphis	1930	108.28	100
Detroit	1931	110.47	100
Average		108.5	100
Part B: Drug Study			
Washington	1929	124.15	100
Cincinnati	1929	120.35	100
Memphis	1930	120.69	100
Detroit	1931	117.48	100
Average		120.67	100

* CHARLES F. PHILLIPS, The Federal Trade Commission Chain Store Investigation: A Note, *J. Marketing*, January, 1938, p. 191.

copper, pipes, paints? When the furniture was purchased for the new house didn't you decide how much would be paid for it and have considerable to say in the selection of it?

"When the family wants a radio, do you or don't you do some short and long waving about it yourself? Do you have something to say about the car you drive or is it your wife and the bright-eyed children who decide the matter while you stand by and utter a check?

"Women may actually put the money on the counter, sign the check, or give the order for 85% or 99% of everything that goes into the home, but can there be a doubt that a great part of the time she is specifying this radio tube, that gasoline, that breakfast food, or this varnish, not only with the *approval* but at the direct *instigation* of her husband? After all, most women will honor their husband's wishes. Nor should it be forgotten (even at the risk of seeming brutal) that it is the man who pays, and paying, calls a considerable number of the tunes."

At the time of the FTC study, independent prices exceeded those of chains by an average of 8½ per cent for groceries and about 20 per cent for drugs. This seems to check with most of the other studies that have been made to determine relative prices between independent and chain establishments.

Fair Trade legislation coming into existence since the inauguration of these studies has probably altered the situation considerably. Particularly is this true in the drug field. The grocery price differential, however, has probably changed very little.[1] In a study of grocery items made at the University of Minnesota in 1933, it was concluded that "the prices charged in ownership chains are markedly lower, grade for grade, than the prices in other types of retail outlets. The average price of grade A products is 16 per cent lower in ownership chains than in all the stores combined. Ownership chain store prices of grade B and grade C goods are, respectively, 10 and 20 per cent lower than the corresponding prices in all stores. These lower prices are offset in part [however] by poorer quality. Ownership chain value, based on a combination of price and quality figures, is 14 per cent higher for grade A products and nearly 10 per cent higher for all grades combined than the corresponding values in all outlets. This greater value in relation to price [the survey found] is offset by the fact that ownership chain prices are for cash and carry service rather than for credit and delivery service, as is the case with most of the other outlets. This finding with respect to price harmonizes rather closely with the studies of prices of identical goods and strengthens the conclusion that consumers may save about 10 per cent on their staple grocery expenditures by patronizing the cash and carry ownership chain stores."[2]

Differences in prices between the types of stores are due largely, though not entirely, to differences in the services that are furnished with the goods. The thing that the consumer purchases in a retail store is not simply a package of raisins, say, but a package of raisins at a particular place and with certain services. The chain store, for example, is usually a cash-and-carry store. It has no credit expense, or loss from bad debts, or delivery expense, and can, in

[1] See for example Ralph Cassady, Jr., and E. T. Grether, Locality Price Differentials in the Western Retail Grocery Trade, *Harvard Business Review*, vol. XXI, winter 1943, pp. 190–206.

[2] Roland S. Vaile and Alice M. Child, "Grocery Qualities and Prices," pp. 13–14.

consequence, afford to sell goods on a narrower margin to those who do not demand these services. An idea of the effect of these services can be gained from the differences in prices charged some time ago by grocers in New York City for seven standard fruits and vegetables. Unit stores furnishing credit and delivery services charged an average price of 27 cents for such products; the cash-and-delivery unit stores, 24.9 cents; and the cash-and-carry units, 23.3 cents.[1] Much the same situation prevails today.

Department stores do not often push their grocery departments. Together with some of the other strictly convenience-goods departments, they are customarily operated at a loss as individual departments. Where they exist, they are maintained because they add completeness to the stock of the store, and a reputation for completeness is an important department-store asset; in this way, the grocery department contributes to the sales of other departments.

Among particular stores of the same class, price comparisons on the basis of single items may not be completely fair. A store sells a wide variety of articles and is likely to be higher on some and lower on others than its competitors. Thus one store may be low on staple groceries and high on canned goods, or low on fruit and vegetables and high on flour and sugar.

Consumers do not generally shop around for each of these classes of goods but choose a store for the general level of its prices, if even this enters into their calculations. In a total of 2,860 housewives included in the U.S. Department of Agriculture's study of consumers' preferences in the case of meat, 56.9 per cent stated that they never shopped among stores in purchasing meat, 31.2 per cent that they shopped among stores sometimes, and 11.9 per cent stated that they shopped among stores a great deal.[2] A study of about 3,100 Columbus housewives by the Ohio State University Bureau of Business Research showed comparative shopping in foods to be the greatest in the case of vegetables, next in meats, and least in the case of general groceries.[3]

The retailers of strictly shopping lines make greater efforts to keep their prices in line with those of competitors than do the retailers

[1] "Expense Factors in City Distribution of Perishables," *U.S. Dept. Agr. Bull.* 1411, p. 24.

[2] "Consumers' Habits and Preferences in the Purchase and Consumption of Meat," *U.S. Dept. Agr. Bull.* 1143, p. 32.

[3] "A Study of Housewives' Buying Habits," *Ohio State Univ. Studies*, vol. 2, No. 16, Bur. Business Res. Monographs No. 3.

of convenience lines.[1] This is very important in shopping lines, since customers are passing constantly from store to store, and sales and reputation will be lost if prices get appreciably higher than in other stores. As has been indicated in another connection, department stores in large cities maintain an elaborate system of "shoppers" who visit the stores of competitors, comparing prices and qualities of goods with those of the home store. When prices are unreasonably low, considerable quantities of goods may be purchased from the competitors without his knowledge as to their final destination and transferred to the shoppers' store to be sold at prices to meet the competitor's. Shoppers also keep watch for new goods and rapidly moving lines.

The prices of specialty goods show a wide range for the different lines. Thus there will be a wide range in the prices of different radios and washing machines. Many of these will be selling at prices out of all proportion to their cost. Any particular make of specialty good, however, is likely to be sold at the same price in the stores selling it. This is because price frequently enters into the advertising, and also because of the close control over the distribution which is exercised by the manufacturer in the case of specialty goods through the exclusive agency or his own retail outlets.

The consumer will do well to look for differences in price, if not constantly, at least at regular intervals. He may be able to save a significant amount, in other words, by purchasing at the proper place. In choosing outlets, each consumer must often decide in the light of his own circumstances whether a saving is worth the inconvenience of paying cash and forgoing services.

[1] Even here, however, there are many opportunities for consumer savings due to an absence of perfection of competition and to differences in the efficiency of retail institutions. There are, for example, differentials between mail-order retail-store and catalogue prices. One of the largest firms in the mail-order field explains the reasons for this situation as follows:

"1. There is no waiting for business.

"Only a third to a half of a retail salesperson's time is spent in serving customers. Mail orders are filled on a 'factory-production' basis.

"2. Actual time spent in filling an order is much less.

"A mail-order clerk can fill orders in less time than it takes a salesperson to sell the same amount of merchandise over the counter. All the mail-order clerk has to do is to fill orders—the customer makes his selection before he mails the order.

"3. Many mail-order operations are carried on by machinery."

3. The Problem of When to Buy. Another possibility of saving lies in purchasing articles at the proper time.[1] The prices of many products vary during the year, and purchases of these products need to be considered carefully. Food is an important group in this class. Fresh fruits and vegetables, for example, are highly seasonal in nature, and there are limited periods in which each constitutes a proper purchase in the lower income groups. There is, likewise, a limited period in which they are sufficiently high in quality and low in price to be particularly suited for canning and preserving. These periods show some variation among years, but, in general, come at approximately the same time.

A valuable aid in proper seasonal purchasing may be obtained through the construction of a seasonal calendar which gives the time when foodstuffs are in season in the local market. Such a

[1] In fact, the city of New York, through its Consumers' Service Division of the Department of Markets, has undertaken the task of informing consumers via the radio as to the time to buy certain commodities most advantageously. The following is an excerpt from a radio talk by its director on July 11, 1938, in which she indicated "best buys" in fresh commodities and supplied hints on the selection and preparation of such foods:

"Good morning, housewives. . . . This morning we have a liberal supply of snap beans and dropped considerably in cost. They continue in the bargain class. Beans are now being shipped from Long Island and New Jersey, also from Pennsylvania and Maryland. . . . When buying remember to select beans that are firm, crisp and tender and will snap easily when broken.

"Kohlrabi is now becoming scarce in the market. . . . Beets are still coming in large quantities from Long Island and near by. This finely flavored garden product is one of the best bargains in the vegetable line. . . . Summer squash, of which there are so many varieties, continues to be listed among the vegetables that are selling at bargain prices.

"Potatoes are plentiful and cheap in the market today. Reports from southern Jersey state that they will have the largest crop in years. Celery, spinach, tomatoes and cabbage are all selling at prices favorable to our budget.

"In fruits, peaches and plums are abundant and selling at slight reductions, and can be classed as a good buy this morning. Those rich, golden apricots from California are in liberal supply and attractive in price. Lemons showed a slight advance this morning due to the warm weather. However, they still are in the reasonable class.

"Good fishing for the past several days will give you a wide choice of varieties. Prices remain pretty much the same as last week with slight fractional changes here and there. The medium and small size weakfish, porgies, haddock, flounder and butterfish are low priced."

The Division also puts out a "Food Purchasing Guide" giving general information on the time to expect plentiful supplies of various types of fresh commodities and simple tests for selecting good quality merchandise in the markets.

calendar would give a list of the products arranged in order, with the length of the season indicated and the period when it is at its height. Figure 16 will furnish an idea of the nature of such a chart of fruits. The student might prepare one for the area in which he resides and for additional commodities. Articles that show considerable variation in price, but not principally seasonal, may be compared with competing products by calculating the ratio of the

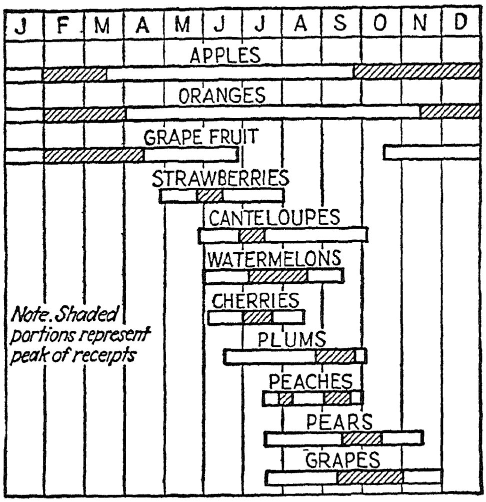

FIG. 16. Period of carlot receipts of certain fruits in Minneapolis.

prices at which a dollar would purchase the same number of calories in each. These may quite profitably be calculated for the major food items. An illustration is given in Table 68.

A somewhat similar situation occurs in the case of shopping goods. Style goods are often priced higher in the early part of the season than they are in the latter part of the season, and slow-moving lines are frequently sold below actual cost near the end of the season. Those who can afford to sacrifice priority of style can make important savings by purchasing at these later sales. Sales of particular lines of goods are conducted at regular seasons of the year by nearly all department stores, *e.g.*, sales of furniture, linens, and men's clothing. The times of these sales should be learned by the housewife and she should adjust her plans to provide for the year's requirements as far as possible at that time. Also, there are often sales in many specialty lines. The contract providing for an exclusive distributorship commonly permits a single sale, or possibly two, during the year,

below the manufacturer's established price. These occur often when a new model appears. Consumers who do not insist upon "the latest" can effect definite savings at such times.

4. The Problem of How Much to Buy. There is also the problem of the proper quantity to purchase. Many of the costs of retail services are related to the single sale and do not vary a great deal with the size of the sale. For example, the cost to the merchant

TABLE 68. RELATIVE PRICES OF MEATS AT WHICH EACH DOLLAR PURCHASES THE SAME CALORIES

Meat considered	Meat considered as a substitute. Ratio which the price of the substitute must be to the price of the meat under consideration in order to purchase equal calories				
	Beef, flank	Beef, round	Ham, fresh	Pork, chops	Lamb, leg
Beef, flank	100	80	134	113	77
Beef, round	125	100	168	141	97
Ham, fresh	74	59	100	84	58
Pork, chops	88	70	118	100	68
Lamb, leg	128	103	172	146	100

When the price of the substitute meat is greater in proportion to the meat considered than the figures in the table, then the purchase of the substitute is undesirable, and when less it is desirable. Thus, if beef flank were 20 cents per pound and ham were 30 cents per pound, the price of ham would be 150 per cent of the price of beef flank and beef flank would furnish more calories per dollar of expenditure.

of selling a peck of potatoes to one customer and that of selling a bushel to another are approximately the same. These differences are roughly adjusted by differences in the proportions of the prices of large and small quantities of the same article. Thus a 100-pound sack of sugar will ordinarily be sold by a retailer at a price somewhat less than four times that of a 25-pound sack. This is in part a matter of cost differences and in part a matter of attempting to induce the customer to concentrate her purchases in the retailer's establishment.

It would often be advantageous, in consequence, for the consumer to purchase in larger quantities than he customarily does. There are, however, a number of factors that must not be overlooked in reaching a decision as to whether to buy in the larger quantity. For

example, one must consider the amount of discount to be gained from the larger purchase, the probable waste and deterioration that will arise from domestic storage, the care required to prevent spoilage, the storage facilities needed, the probable effect of the larger quantity on hand on the waste in cooking and at the table, and the investment involved in the purchase. Some goods—*e.g.*, tinned foods—often can be advantageously purchased for a year at a time when funds and storage facilities are available. It may be appropriate to purchase supplies of other things for shorter periods. Proper planning will enable quantity purchasing to save not only the household money but the time of the housewife as well.

There is some possibility of gaining the advantages of the lower prices on larger purchases through the combination of the purchases of a number of households. There are a number of cases of employees in particular plants making regular group purchases of special commodities, such as butter. These sometimes take the form of informal buying clubs, covering a wide range of purchase. However, such organizations depend for their success principally on the activity and vigor of their leaders, and except for short periods they are usually not successful.

5. The Problem of What to Buy. The problem of what to buy is at once the most important and the most difficult of the several purchasing problems. It involves actual selection of merchandise from a wide variety of items which fall into innumerable price lines. The task of the consumer is that of matching offerings and requirements.

Not every buyer requires the highest quality merchandise. The consumer's job is to determine the quality required and then discover the item that promises to satisfy the requirements most exactly. This task is sometimes very difficult. For example, the several qualities of riding ease, smoothness, long life, economy, and beauty in automobiles are of varying importance to different individuals. Moreover, the several cars offered the consumer possess these qualities in varying degrees. A sound decision with respect to a combination of required qualities followed by a careful canvass of the field is essential to the successful culmination of the buying transaction. Many merchandise-selection problems are equally complex. Hence, guides to purchasing are of great importance.

Prof. Jessie V. Coles has presented a number of guides to purchasing which, though possessing limitations, should be exceedingly

helpful to the consumer-buyer.[1] An evaluation of these several guides follows.

1. *Price,* though of some help to the consumer-buyer, is not completely adequate as a guide. The reason for this is that the consumer market is so imperfect that the producer of overpriced merchandise often is not forced to revise the prices of his offerings. Indeed, quasi monopolies actually thrive on imaginary differences in quality and are nurtured by means of brand advertising. To be sure, the highest priced articles very often possess a high degree of quality, but the average consumer cannot afford a differential just for the purpose of quality insurance.[2]

Available evidence leading to conclusions regarding a close relationship between quality and price is somewhat conflicting. For some products one can assume such a relationship; for others the correlation seems not to exist. For example, in their grocery study, Profs. Vaile and Child conclude that the differences in quality between the high and the lower grades of canned goods are almost exactly proportionate to the differences in price. On the other hand, "Laboratory tests by the National Bureau of Standards of 111 pairs of silk hosiery showed that most of the hosiery selling for $1.00 was

[1] JESSIE V. COLES, "Standardization of Consumers' Goods."

[2] Careful studies under laboratory test conditions have shown that a substantial proportion of consumers indicate a preference for inexpensive rather than expensive goods. In such a study covering coffee, wine, and butter (R. M. DORCUS and J. LEEDS, The Relation Between Subjective Estimates of the Quality of Certain Food Products and Their Cost, *Am. J. Psych.,* April, 1942, p. 262) it was found that out of those tested ". . . 43 (38.5%) preferred the cheaper coffee; 58 (51.7%) preferred the more expensive brand; . . . 10 (8.9%) would express no preference. The wine experiment showed less decisive results: 50 (45.4%) selected each brand; the remainder 10 (9%) would express no preference. . . . [In the final experiment on food preferences] 47 (42.3%) preferred the cheaper butter, . . . 50 (45%) preferred the expensive butter, and . . . 14 (12.6%) would make no choice."

Similar and even more striking results were found in the perfume field (GLADYS M. JEWETT, A Note on the Relation Between Subjective Estimates of the Desirability and the Lasting Quality of Certain Perfumes and Their Cost, *J. Gen. Psych.,* October, 1945, p. 288): "Out of 130 judgments made for each pair of perfumes, 57 (44 per cent) favored the inexpensive Lilac [costing 50 cents an ounce], and 73 (56 per cent) favored the expensive Lilac [$16 an ounce]; 71 (55 per cent) favored the inexpensive Gardenia [50 cents an ounce]; and 59 (45 per cent) favored the expensive Gardenia [$8 an ounce]; 40 (31 per cent) favored the inexpensive Apple Blossom [50 cents an ounce], and 90 (69 per cent) favored the expensive Apple Blossom [$8 an ounce]."

superior to stockings of the same weight selling for $1.65 and $1.85. . . . Manufacturers of dresses frequently use the same materials in goods selling at $6.75, $7.75, $8.75, $10.75 and $12.75. Some specialty shops buy dresses for $10.95 that are commonly retailed for $16.95 and put hand rolled hems in them and change an ornament or two and sell them for $29.50 and $39.50."[1] The correlation between quality and price has also been found to be low in boys' clothing, towels and sheeting, toilet goods, and razor blades.[2] And so it can be seen that price, though somewhat helpful in selecting certain types of products, is far from adequate, generally, as a buying guide.

2. *Inspection* is of some value in the selection of merchandise. It is definitely helpful in choosing books and in determining such qualities as the odor of perfume, the color of cloth, or the fit of a garment. It is definitely limited, however, in that it fails to detect such things as an absence of fastness of color, the presence of weighting in silk, and inferior inner construction of furniture. There are the further limitations that the consumer has not the time to inspect all offerings and that some commodities cannot be inspected since they are put up in sealed containers. Inspection where practicable should be utilized in merchandise selection, however; and the better the training the buyer possesses, the more effective will be its results.

3. *Experience* is definitely helpful as a guide to purchasing and can be used to supplement inspection. The consumer-buyer should assume an unbiased experimental attitude in purchasing, recording results where necessary in order to derive the greatest profit from purchasing experience. Though experience is an exceedingly valuable guide to purchasing, it also possesses certain limitations. For one thing, because of an absence of adequate time and energy, experience is often not broad enough. Moreover, the consumer in many instances is unable properly to control conditions under which comparisons are made. That is to say, variations in the condition of use may affect the results one way or another. Furthermore, full advantage cannot always be taken of knowledge gained, because of an absence of product identification or because of quality changes which have been made in the goods that are offered.

4. *Testing* is closely allied to experimentation, and, although it is advantageous to large buyers, it is of limited practical value to consumer-buyers. Usually scientific testing requires time, technical

[1] Norris A. Brisco and John W. Wingate, "Buying for Retail Stores," p. 145.
[2] *Ibid.*, p. 145.

knowledge, and equipment that consumers do not possess. Moreover, for some types of merchandise, samples are difficult if not impossible to obtain. Some advocates of testing seem to assume, for example, that obtaining a swatch from a $3.98 dress offers no problem! Testing as a guide to purchasing, then, leaves much to be desired.

5. *Trade-marks* as sources of buying information are inadequate in and of themselves but are of great value in facilitating the use of other buying guides, *i.e.*, inspection, experience, and advertising. They make possible not only the repurchase of satisfactory goods but also the avoidance of repetition in the purchase of unsatisfactory goods. The value of trade-marks for this purpose, however, depends upon uniformity of product quality which is not always existent. Moreover, lack of homogeneity (inherent in some kinds of products, *e.g.*, fruits and vegetables) might result from a change of source by the retailer or from a deliberate impairment of quality for the purpose of keeping prices uniform.

6. *Advertising* as it exists today is not in itself an adequate guide to purchasing. Noninformative advertising, indeed, is a misguiding and confusing influence. Much advertising is still of the noninformative type. An examination of 145 advertisements of textiles and clothing, for example, revealed that only 34 per cent were informative (regarding price, uses, specific facts on color, fibers, etc.) and that the remainder, 66 per cent, were noninformative (confining their statements to general claims of economy, smartness, newness, distinctiveness, etc.).[1] Advertising is, however, potentially of great value to the consumer-buyer. In fact, even as it exists today, advertising is useful in informing the consumer-buyer concerning the availability of goods, their prices, and their uses. And as a result of such information, other guides to selection (inspection, experience, etc.) are made more effective by indicating which goods should be examined.

7. *Labels* are often of greater aid to consumers than advertisements in that labels on certain types of commodities (owing to food and drug legislation) tend to be more accurate. Labels are not completely adequate, however. It must be recalled that, according to the old law, statements on food need not be made unless there was a substitution in its ingredients or unless it contained narcotics; unless it was in packaged form, in which case the quantity of the contents must be stated and whatever statements were made must be truthful. The law regarding labels on drugs was somewhat more

[1] COLES, *op. cit.*, p. 59.

drastic.[1] Uses to which goods may be put as well as directions for use are important to the consumer-buyer. Information as to the date of packing commodities subject to deterioration may be extremely important, and facts about the quantity held by a container and about the composition of the contents may be of great aid to intelligent commodity selection. Labels are often helpful as an aid to inspection in any case.

8. *Guarantees* (specific or implied) may be of some value in selecting merchandise. Sometimes merchandise is guaranteed by the producer. Often, however, the dealer assumes this responsibility, the reputable dealer usually allowing the consumer the privilege of returning unsatisfactory goods. Though returning goods may be inconvenient and costly to the consumer, guarantees ensure the buyer against any substantial financial loss, a very important consideration in some instances. The purchaser, though, may have to pay a higher price for guaranteed merchandise. Whether it is worth while to do so depends upon the circumstances. Although there is certainly no evidence lending support to a contention that guaranteed merchandise is better than that which is not guaranteed, if other conditions remain approximately equal, it is probably better to purchase the former.

As can be seen from the foregoing analysis, the several buying guides that are available at present are not completely adequate

[1] The Food, Drug and Cosmetic Act has the following labeling provisions:

(*a*) For foods—

1. In foods for which no definition or standard of identity has been prescribed (and except for spices, coloring, or flavoring in which case they may be simply designated as such) ingredients must be named.
2. Except for butter, ice cream, and cheese, labels must declare artificial coloring, flavoring, or chemical preservatives.
3. Special dietary foods must have informative labeling as to vitamin, mineral, or other dietary properties.

(*b*) For drugs—

1. Labels of official drugs must reveal any differences in strength, purity, or quality from the official standards (USP, NF, or HP).
2. Labels of nonofficial drugs must list active ingredients.
3. Labels of drugs and devices must bear adequate directions for use as well as warnings against probable misuse.
4. Labels on drugs intended for use of man must bear warnings against habit formation if they contain any of a certain list of narcotic or hypnotic substances.
5. Labels on drugs subject to deterioration must have a printed warning to that effect.
6. Poisonous coal-tar hair dyes must bear warning labels.

although each can be used advantageously under certain circumstances. If utilized, however, it is necessary that the consumer use them intelligently. "Generally speaking, education of the household buyer which increases her information, intelligence and discrimination is an important method of increasing efficiency in buying. Teaching her how to know and use the available methods of choosing goods and how to identify and compare characteristics of particular goods, will aid the household buyer in meeting many of the practical difficulties of market selection."[1]

Much time and effort could be saved and more efficiency gained if standardization were more generally practiced in the production and sale of consumers' goods. For if standardization were in existence generally (assuming that consumers were properly educated with regard to the resulting grades), the buyer could effectively compare values and choose the items that would exactly satisfy his specific requirements.

6. Grade Labeling. The term *grade labeling* refers to a system of labeling consumers' goods according to broad quality groups based on definite standards or tests. *Brand labeling*, in contrast, is the use of a name, picture, and/or emblem to differentiate a product from that of other producers; such name, picture, or emblem is designed to be retained in the buyer's mind in order to encourage repeated selection of that producer's product rather than some other. *Descriptive labeling*—still different—is the setting forth on the label of some characteristics of the product, such as the style of pack or the size or variety of the fruit, or in nonfood items, the wool content of a garment, for example.[2] These different types of labeling are not mutually exclusive, but may all be utilized at one time; in fact, it is not unusual to find all three types employed simultaneously.

One thing that should be kept in mind from the outset is that grade labeling does not, as some seem to think, enable the consumer to know precisely the quality of product he is acquiring.[3] The fact

[1] COLES, *op. cit.*, p. 29.

[2] These designations and much of the material in this section have been adapted from the excellent article on grade labeling by Jessie V. Coles and H. E. Erdman, Some Aspects of the Arguments Against Grade Labeling, *J. Marketing*, January, 1945, pp. 256–261.

[3] According to Prof. G. B. Hotchkiss (Some Fundamental Objections to Mandatory A.B.C. Grades, *J. Marketing*, October, 1945, p. 129), ". . . a high executive of a co-operative organization asserted that the grades enabled the consumer to know *precisely* the quality she is getting [italics the Professor's]." The author's loss of patience with such a statement certainly is understandable.

is that, for natural products such as fruits and vegetables, not only are quality differences gradual, but two products having the same grade may be composed of quite different combinations of qualities since grades are based upon not one, but several criteria.[1] The result is that, in order to know *precisely* what she was getting, a housewife would have to have an infinite number of grades available, each one based upon a different criterion (size of fruit, freedom from defect, etc.). This obviously would not be practicable.

The consumer merely obtains from grade labeling the knowledge that, according to a scoring system presumably based on factors having a direct bearing on product quality, offerings in the market are rated from high to low on a scale so that she may (1) have an *idea* of what the product quality is before buying, and (2) compare the prices of offerings of similar quality. Admittedly, some intra-grade differences are bound to exist even under a program of grade labeling in nonmanufactured-goods lines, since it is inconceivable that a pack should be given exactly the number of points for each factor tested and precisely the correct total number of points to reach the level of a particular grade. But even within the limitations, assuming that she knows what her requirements are, a housewife should find it easier to effectively seek out and procure needed merchandise under a system of grade labeling.

While we do not have mandatory grade labeling in fruits and vegetables thus far, at least, mandatory labeling programs have been instituted by certain states for use in particular fields. For example, since 1935 the state of California has required that butter be designated 1, 2, or 3 on the package, and since 1939 that state has required that eggs be labeled AA, A, B, or C. It is said that both laws have worked quite well.[2] Milk, too, is successfully graded in most locali-

[1] For canned peaches, the criteria used by the USDA and the points assigned to each are as follows:

Uniformity of size and symmetry	15
Color	20
Absence of defect	30
Tenderness or maturity	35
	100

Peaches must have not less than 90 points in order to be designated Grade A; not less than 75 points to be rated Grade B; and not less than 60 points to be designated Grade C. The weight of the syrup, note, is not included among the quality criteria; a separate statement is required to indicate whether the syrup is heavy or light.

[2] COLES and ERDMAN, *op. cit.*, p. 260.

ties.[1] From late in 1942 (when it replaced a voluntary scheme) the Federal government, through the Meat Grading Service of the Department of Agriculture, had a system of compulsory grading in effect for meat.[2] Unless exempted by the Department, all beef, lamb, veal, and mutton had to be graded and the proper grade stamped on the carcass of the animal,[3] during the life of the OPA. The customer was thus aided in distinguishing high- from poor-quality meat (*choice* or *good* as against *commercial* or *utility*). Meat grading is now voluntary, with the result that while most of the higher quality product is still graded, very little of the low-quality commodity is so treated.

In canned fruits and vegetables, two voluntary schemes of Federal grading are provided:[4]

1. Grading of individual shipments. Thus a request may be made by someone having a financial interest in the product to inspect a shipment by sample, a small fee to be paid by those for whom the service is rendered.

2. Continuous factory inspection.[5] Here application may be made by a packer desirous of such service; the service includes the grading of all the product of the plant and the use of the designations "U.S. Grade A" (Fancy), "U.S. Grade B" (Choice), "U.S. Grade C" (Standard), or such other grades as may be necessary. The cost of such service must be borne by the packer.

[1] See "State Milk and Dairy Legislation," Marketing Laws Survey, WPA, 1941, vol. III, pp. 371–380.

[2] Not to be confused with meat inspection, discussed elsewhere. The authority for the grading program is derived from OPA Administrative Order No. 1267, issued by Leon Henderson, Administrator, Dec. 11, 1942.

[3] The Dept. of Agriculture grades are: Prime (not utilized under OPA regulations), Choice, Good, Commercial, Utility, and Canner and Cutter. The criteria by which an animal is graded are (1) Conformation, (2) Finish, and (3) Quality. For further information, see the following Dept. of Agriculture bulletins: "U.S. Graded and Stamped Meat," *Leaflet* No. 122; "Federal Beef and Grading," *Misc. Pub.* No. 391; "Buying Beef by Grade," *Misc. Pub.* No. 392.

[4] See "Questions and Answers on Government Inspection of Processed Fruits and Vegetables," *Misc. Pub.* No. 598, Production and Marketing Administration, April, 1946.

[5] This should not be confused with the job of the Pure Food and Drug Administration in promulgating minimum standards for canned fruits and vegetables, required by the amended Pure Food and Drug Act of 1938. This latter law calls merely for *minimum* standards of identity, quality, and fill of container (which if not met must be so stated on the label) and requires no quality gradations for goods meeting such standards.

It should be kept clearly in mind that these services are permissive only; canners may or may not choose to use the services offered. The cost of such service, incidentally, is very low, reportedly running from ¼ to ½ cent per case of 24 No. 2 cans. The Great Atlantic and Pacific Tea Company has been selling grade-labeled fruits and vegetables under its own brands for some years.

It should be interesting for the student of consumption economics to consider the efficacy of a system of mandatory grade labeling. In so doing, it might be well, first to consider and evaluate some of the objections to mandatory grade labeling that have been voiced from time to time. It has been argued that

1. Important qualities cannot be measured objectively (*e.g.*, flavor), or, as a corollary, that qualities are measured which are not relevant. Against this contention is the fact that qualities that cannot be measured are closely correlated with others that *can* be measured objectively, with the result that sound information often is obtainable on immeasurable factors. By measuring the size of the air cells in eggs it is possible to learn a great deal about their freshness, thus their flavor; and by counting the threads in an inch of textile fabric much is learned about its durability.

2. Grades are arbitrary—it is contended—with the result that the product just meeting the standard for A quality and that which just fails to reach it are essentially the same, but are graded differently. While this is no doubt true in some instances, it would not appear to be a valid criticism, since any canner selling part of his pack under a top brand and another under a different label must also draw an arbitrary line and thus to condemn one is to condemn the other.

3. Judgments have to be made by human beings in regard to rather subjective things—it is said—and errors are bound to develop out of such decisions. Against this it should be kept in mind that human decisions have to be made by food and drug inspectors, indicating that a product does or does not reach a certain standard; indeed, such decisions are continually being made by inspectors who have to decide whether the product is up to the standard of the "Del Monte," "Libby," or "S & W" label. Added to this is the important fact that (a) whether employed by government or industry, graders must undergo rigorous training and become highly skilled as a result; and, in any case, (b) graders rely more on chemical and physical tests than on judgment.[1]

[1] COLES and ERDMAN, *op. cit.*, p. 258.

4. In grading goods into one of three categories—A, B, or C, say—it has been contended that a difficult marketing problem might arise, in that a lack of balance of supplies might develop among the grades as compared with the demand for the product in each grade. The difficulty envisioned in this argument is not insurmountable if, for one thing, proper publicity could be directed toward educating consumers as to grade differences, with the result that many would find that all or a part of their requirements could be satisfied by Grade B merchandise. Thus demand would be increased. In any case, price could be expected to adjust the amounts taken to existing supplies of various grades of the product, and if (as certain evidence leads us to believe has been the case)[1] the in-between Grade B product proved undesirable at one price, price adjustments could be relied on to move such merchandise.

5. A system of compulsory grade labeling would so standardize goods—some argue—that all packers' products would be the same; thus, selling by brand would be precluded and, as a corollary, there would be a tendency on the part of packers to reduce quality to the minimum rather than to pack a premium product. This would seem to be an erroneous conclusion; it seems more likely that some canners would choose rather to produce a high-quality product and promote it as a premium brand. There would, we think, be plenty of room for intragrade quality differences under a system of mandatory grade labeling.[2]

Probably the greatest effect of mandatory grade labeling on the economic system would be that of intensifying competition in those fields in which the scheme is put into effect, assuming that consumers were properly informed concerning the meaning of grade designations. The reason for this should be quite clear if the student recalls that one of the causes of market imperfection is the absence of knowledge (*e.g.*, lack of knowledge of satisfactory competitive offerings) and that grade labeling provides such information, in part at least. Mandatory grade labeling would provide more and better information on

[1] See G. B. Hotchkiss, *op. cit.*, p. 130.

[2] Against this, Professor Kebker (Will Grade Labeling Pay? *J. Marketing*, Oct., 1943, p. 187) found that while 82 per cent of housewives interviewed knew that they could not expect all brands of the same grade to taste alike, only 40 per cent could think of any reason why they should pay more for one graded brand than another if both were the same grade. This does not suggest the impossibility of selling a grade-labeled product at a premium price, but indicates that it would be more difficult and that a real quality difference would have to exist.

the buyers' side of the market, so that the housewife would be enabled to choose among a number of competing products with a greater chance of success in obtaining the type of product she requires. Moreover, unfamiliar brands would be able to compete more effectively with well-known brands (if, as usual, the price of the former were lower), with a resulting tendency toward reducing the price and increasing the quality of the latter. The consumer-buyer who formerly did not care to take a chance in the purchase of unknown products would at least know that the product had met certain quality standards. A well-known packer's product which was up to the standard of the A grade or higher would still have the inside track; on the other hand, if it were below this standard it would be forced to compete price-wise rather than to rely upon established consumer preference to move it, as at present.

Recent studies have indicated that consumers require education in grade labeling if they are to benefit from its use. The study in Lawrence, Kans., mentioned before, indicated that less than half (47 per cent) of those purchasing graded canned goods were influenced in their selection by the grade designation on the labels; that a substantial proportion of those buyers (36 per cent) did not even realize that it was graded merchandise. Such an educational campaign probably would have as one of its purposes that of instructing consumer-buyers to look for the designations and informing them of their various meanings in each merchandise line. Thus, if the consumer knew the qualities of Grade B and Grade C merchandise, certain individuals would find that such merchandise was perfectly satisfactory from their standpoint, and most individuals would find, perhaps, that such merchandise was satisfactory for *some* of their requirements (*e.g.*, B and C fruit might be quite satisfactory for use in salads). The idea would be to dissolve the bad connotation of the B and C designation; to substitute fact for fancy. There is little question but that such a campaign is essential if consumers are to receive the full benefits developing out of such a scheme.

When we look about us, it is interesting to find the extent to which grade labeling is being practiced in our economy, with or without the force of law. Some instances have already been mentioned, but there are others. The whole consumers'-goods information-service type of activity (Consumers' Research and Consumers' Union), to be discussed later, is an application of this principle, although in this case the goods are not specifically labeled with a grade designation. Sears,

Roebuck and Company have been utilizing a kind of grading scheme to a limited extent in connection with their catalogue business. Thus in an issue of their catalogue several years ago many items of merchandise (women's coats, women's nightgowns, men's undershirts, boys' denim jeans, laundry tubs, and cotton sheeting, to name only a few) were offered in three "grades" designated Good Quality, Better Quality, and Best Quality.[1] The company by no means attempted to grade all products in this manner; in fact, certain items probably are not susceptible of such treatment. Thus it may be significant that among others, typewriters, drugs, phonograph records, watches, dishes, and dining-room furniture were not so designated. This application of the grading technique declined during the war, possibly due to shortages of merchandise. It will be interesting to see whether this development is continued when goods have become really plentiful once again.

One of the most interesting applications of grade labeling is found in the field of investments.[2] The Illinois Blue-sky Law requires that securities handled within its jurisdiction must be classified or graded and the purchaser informed into which group the proposed investment falls. Securities are divided into four classes alphabetically designated as follows:

A. Securities whose inherent qualities ensure their sale and disposition without fraud.

B. Securities whose *condition of sale* is such that disposition without fraud is ensured.

C. Securities whose income is established—*i.e.*, those issued by a concern in continuous operation for not less than two years and showing earnings of a certain specified minimum.

D. All securities not falling into the other three classifications.

All Class A and B securities are exempted from the provisions of the Illinois Blue-sky Law, while securities in Class C may be sold only after specified information is furnished the Illinois Secretary of State as an aid in establishing the character of the securities. Class D securities may be sold only when the following condition in boldface type appears on each financial statement, prospectus, advertisement, etc., distributed in connection with their sale: "Securities in Class 'D' under Illinois Securities Law. These are speculative securities."

[1] Sears, Roebuck and Company's "Fall and Winter Catalogue," 1941–1942.

[2] This material is based upon an article by James Waterhouse Angell, The Illinois Blue Sky Law, *J. Pol. Econ.*, April, 1920, pp. 307–321.

It is interesting to contemplate the limits of applicability of grade labeling in the abstract.[1] One might make the general statement that applicability is limited to those fields in which meaningful standards can be set up, which have a close relationship to *merchandise quality*, and in which merchandise quality is of paramount importance as a factor in purchasing (although admittedly a difficulty here is assigning limits to the term merchandise quality). Men's shirts might thus be graded on a basis of thread count, fastness of color, extent of shrinkage, fullness of cut, etc.; but in such an instance applicability would be limited by the extent to which style is an important consideration in purchasing, although even here color and design might conceivably be rated within certain broad limits, perhaps, by a representative group of consumers.[2] The selection of phonograph records is accomplished presumably on a basis of individual taste and therefore, except in their physical aspects—susceptibility to warping, length of life, etc.—probably not subject to grading. Drug products, it would seem, cannot very well be graded in the strictest sense for the reason that *all* such merchandise is assumed to be of first quality. Using the foregoing as preliminary and tentative, it is suggested that the student formulate a brief statement of limitations to the applicability of grade labeling in our economy.

7. Consumers' Information Services. More and more specific information on purchasing is becoming available to consumers.[3] Two very interesting agencies now exist having for their purpose the education and instruction of consumers in more effective pur-

[1] One practical limitation to grading some goods at present is the fact that we do not have the necessary information regarding factors which are important to consumers and, particularly, their relative importance; in some cases practical methods of measurement are not as yet available. For others see TNEC Monograph No. 38, "Consumer Standards," 1941, pp. 350–353.

[2] In some cases it may be desirable or even necessary to grade certain qualities, or certain groups of qualities, separately from others.

[3] In addition to that published by Consumers' Research and Consumers' Union (discussed in detail in the following paragraphs), valuable information on buying can be obtained from the following sources: Household Finance Corporation's series of booklets on "better buymanship"; the National Better Business Bureau's series of pamphlets on various types of commodities (furs, jewelry, etc.); The Bureau of Human Nutrition and Home Economics (USDA) pamphlets on foods, diets, textiles, equipment, etc.; Consumers' Project's (USDL) booklet on drugs, etc. For a rather extensive discussion of the extent and character of commodity information available to consumers and the value of grades, standards, and labels in consumer purchasing, see TNEC Monograph No. 21, "Consumer Standards," 1941, Chaps. VII and VIII.

chasing. These are known as Consumers' Research, Inc., and Consumers' Union of the United States. Since they are essentially the same, they will be discussed as one.

The consumers' information services publish two types of information: (1) general consumer information on such subjects as the advisability of building a home and the pitfalls to be avoided if one does build; the maintenance and care of automobiles; what to look for in purchasing furs, life insurance, etc.; and (2) specific consumer information regarding competitive items. Each of the aforementioned agencies publishes a monthly bulletin containing information on automobiles, nylon stockings, vacuum sweepers, safety-razor blades, cold remedies, fountain pens, etc. Each publishes periodically, in addition, a buyers' guide which summarizes in more usable form much of the information previously published.

In effect the consumers' information services tear the wrappers from the commodities and grade them, not according to the claims of their biased producers but according to the value of the product as revealed by tests. Ratings are based upon quality and price. Hence, products of good quality and low price would be recommended whereas those of low quality and low price or even good quality and high price may be rejected.

Each product tested by these agencies is eligible to any one of three ratings. Items are then classified as (1) those whose superior quality and low price earn them best-buy rating; (2) those whose values are neither high enough for best-purchase rating nor low enough to be condemned;[1] and (3) those which because of low quality or high price or both are considered unacceptable and hence are not recommended. With certain types of products (brake linings, say), very little explanatory information need accompany the ratings. With other types of commodities (*e.g.*, automobiles) lengthy explanations are required. The reason for this is quite clear. The former are rated on a very simple basis—length of life and price. The latter, however, must be rated, in addition, on the bases of riding comfort, ease of handling, gasoline mileage, general cost of upkeep, roominess, etc.

The careful consumer-buyer cannot afford to be without one of the two consumers' information services. Valuable advice is given with respect to home manufacture of certain types of commodities, the avoidance of the use of harmful products, the care of mechanical devices, a fuller utilization of motor lubricants. Best buys may be

[1] The Consumers' Union medium rating is somewhat different from that of Consumers' Research. The former designate the middle group as also acceptable.

discovered in chain department stores, mail-order retail institutions, catalogue houses, or five-and-ten-cent stores. The market undoubtedly can be more effectively covered by these consumers' agencies than if each consumer were to undertake the task alone. As a matter of fact, the consumer can use the services to his advantage as a supplementary aid to his own inspection and testing activities. Through the work of Consumers' Research and Consumers' Union, the consumer-buyer has at his disposal, for a relatively small fee,[1] unbiased information concerning the things he buys.

The idea of furnishing the consumer with unbiased information concerning goods and services is not unique. For years the book review sections of *The New York Times* and the *New York Herald Tribune* (as well as others) have furnished expert quality information to buyers of books. In addition there are now in existence guides to current motion pictures which furnish summaries of plots and expressions of opinion regarding the quality of each production. The most recent suggestion along these lines would provide for an extension of consumers' information services into the field of investments.[2] The originator of the idea, Mr. Reis, was secretary-treasurer of Consumers' Research in 1932–1933 and was probably inspired by his experience in the field. His plan (which might well be termed *investors' research*) " . . . is to form a national organization with dues assessed to individual security holders according to their holdings. A paid staff of lawyers, accountants, and financial experts would analyze and evaluate new issues as applications were made to the SEC for listings. Investors' Research would not only issue confidential bulletins to members but they would attend stockholders' and bondholders' meetings, play watch-dog on corporate activities, maintain . . . legislative lobbies to protect investors' interests. . . . "[3] Further activity along these lines might be expected as more normal economic conditions return.

There are, of course, certain technical limitations to the type of consumers' information services outlined above. In the first place, the testing of certain types of products, particularly durable consumption goods, is extremely expensive. Considering their small number of subscribers (it is doubtful if either of these agencies has a subscription list exceeding 100,000 at the very most), one can readily see that adequate testing of certain types of products is impossible. Though it is

[1] Each service has been priced at $3 per year.

[2] BERNARD JOSEPH REIS, "False Security—The Betrayal of the American Investor."

[3] *Time*, May 10, 1937.

true that these agencies have certain nonprofit research facilities at their disposal, some of the ratings actually are based upon opinions of users of the products reported on. These opinions may or may not be sound. In the second place, many of the products rated have many important qualities, not just one. In such cases, the consumer must take care that he understands the basis of the rating since what

TABLE 69. COMPARATIVE RATINGS OF CONSUMERS' UNION AND CONSUMERS' RESEARCH ON SELECTED IDENTICAL MERCHANDISE ITEMS*
(In terms of per cent of highest score attainable for identical items tested)†

I. Perfect agreement	Per cent of perfect	III. Some agreement	Per cent of perfect
Automobile tires	100.0	Sheets	55.5
Bicycles	100.0	Men's shoes	55.0
Silver polish	100.0	Bathing suits	50.0
Toy chemistry sets	100.0	Toothbrushes	50.0
Typewriters (portable)	100.0	Hair tonics	40.0
White lead paint	100.0	Toilet soap	33.3
II. Close agreement	**Per cent of perfect**	**IV. Little if any agreement**	**Per cent of perfect**
Men's shirts	92.0	Electrical food mixers	16.7
Shaving creams	90.0	Electric shavers	16.7
Bathing caps	83.3	Razor blades	16.7
Summer automobile oils	75.0	Vacuum cleaners	8.5
Automobiles (low-priced)	71.0	Shoe cleaners	0.0
Mechanical refrigerators	71.0	Shaving lotion	−30.0

* Adapted from IRA I. BERMAN, A Comparison of the Ratings of Consumers' Research and Consumers' Union, *J. Retailing*, October, 1940, pp. 78–80.

† Method: On a basis of plus 2, plus 1, and minus 1, for identical ratings, similar ratings, and absence of agreement respectively, the total number of points is determined for all brands rated by both services. Then this figure is expressed as a per cent of the highest possible score (two times the number of brands rated). For example, if three brands appeared in both services and one was rated exactly the same in both, one was recommended by both, but was considered a "best buy" by only one service, and one was recommended by one organization and not recommended by the other, this would total plus 2 points ($2 = 1 + 1$); and since it was possible to attain 6 points, the score would be $33\frac{1}{3}$ per cent.

seemed an undesirable feature to one individual might be of no consequence to another. This does not vitiate the system, however, since a careful study of the bases of each rating actually can be made by the consumer. Finally, qualities and prices change from time to time, each change having the effect of vitiating previous ratings. As a result of these and other factors the ratings of the two leading agencies in the field often do not agree, as is indicated by the figures in Table 69. Hence the consumer should utilize the existing agencies as guides only, not as final arbiters of product choices.

These agencies while imperfect are of invaluable aid to the consumer, however. They are particularly necessary in our present society since standardization is generally nonexistent and since, despite legislative devices, adulteration, misbranding, and false advertising actually are practiced from time to time.

If the consumers'-research type of activity were carried out to its ultimate conclusion, it would result in a more perfect market, since the improvement would come in the ordinarily inadequately informed buying side of the market. Although there would be a conflict at first between advertisers' claims and information supplied by the consumers' agencies, in time, if the consumers' information services were a generally accepted device, untruthful advertising would cease to exist. Producers would have to turn to informative advertising, and those producing poor products would perforce improve the quality of their products, place them in lower price brackets, or be forced out of business.

8. Installment Buying. Installment buying is based upon a form of credit that is paid off or liquidated by installment payments; *i.e.*, the payments are made piecemeal or in successive fractions under a plan agreed upon at the time the marketing transaction is initiated. Although this type of credit is based upon trust and confidence in the debtor's ability and willingness to pay, the object sold is most often utilized as a part of the security.

The use of installment financing in the sale of consumers' goods is not a new phenomenon. As early as 1750, for example, Chambers's "Encyclopaedia" was sold on this basis. Singer Sewing Machine Company has been doing a profitable installment business since 1850. There are many other similar cases. But the major impetus to installment selling was received in the early 1920's. In other words, although the device itself is not new, installment-sales volume increased tremendously following The First World War. By 1929 installment-sales volume was over 12 per cent of total retail sales,[1] or between 6

[1] In some industries, the percentage of installment sales to total sales is very high; in others, negligible. The U.S. Department of Commerce, some years ago, estimated the percentage of business (in terms of units) on an installment basis in certain products as follows:

	Per Cent
Stoves and ranges	73
Furniture	58
Musical instruments	55
Electrical appliances	49
Radios	29
Jewelry	17
Furs	11

and 7 billions of dollars.[1] As one aspect of price control, credit restrictions were imposed during the Second World War. These were lifted some months after the war was over but were invoked once again in late 1948 (Sept. 20) as an anti-inflationary measure.

It is generally agreed that products which lend themselves to installment selling most satisfactorily, from an individual vendor's point of view, should possess:

1. Durability, since the product acts as security for the loan.

2. Relatively high and slowly declining resale value, in case of repossession.

3. Moderate degree of standardization, since resale depends upon a fairly wide market.

4. Fairly high initial cost, since the buyer, otherwise, usually finds little need for long-term credit.

Much can be said for and against installment selling. In its support, one must insist that in some instances installment credit merely replaces another type of consumer credit. That is to say, open-book credit is replaced by the sounder, more formal, installment credit. Moreover, installment credit encourages saving in kind. For the purchase of ephemeral commodities it substitutes, in part, the purchase of durable commodities. Without it, many individuals would dissipate their incomes on transitory goods. Again, it makes possible the purchase of better quality products since the purchaser is not limited, in the amount to be spent, to the sum actually in his possession. Furthermore, it probably has made possible decreased costs in certain commodities, since increased production often follows introduction of long-term credit terms.[2] And, finally, the argument is advanced by some that scales of living are raised through installment credit since an individual strives harder (and thus becomes more pro-

[1] Some of the more important reasons for the increase in installment business following the First World War were as follows:

1. Excess plant capacity following the war and postwar boom made necessary experimentation with various sales stimuli.

2. Increase in real wages from 1921 to 1925 made this stimulus effective, since consumers were optimistic, hence, amenable.

3. Falling off in automobile sales about 1923 caused finance companies to seek new products to finance.

4. Interindustry competition (*e.g.*, automobiles vs. furniture) forced those industries not selling on time into the installment field.

5. Business-seeking methods of reducing sales resistance in order to make advertising more effective promoted installment buying.

[2] This may have affected other industries adversely, however. For example, home building may be affected by increased automobile sales.

ductive) when goaded on by the necessity of meeting the installments on his various purchases. The last two points are subject to some debate.

There are, however, several important indictments of installment selling. The first is that in installment selling many racketeering practices obtain. In New York State, for example, by means of wage assignments, an installment creditor on default of contract may demand of a present or subsequent employer the entire wage due a debtor until the account is liquidated.[1] This, one must insist, leads to great hardship in many families. Repossession fees also lead to harmful results. In some contracts, if the commodity is repossessed the debtor must pay an exorbitant fee in order to regain possession of the commodity.[2] Moreover, exorbitant interest and service-charge rates are demanded by many small local companies. Though one cannot indict the whole system on account of a minority of shady dealers, consumers should be warned of such dealings in order that they be enabled to protect themselves.

A second indictment of installment selling rests on the fact that by means of the device the consumer can be more easily influenced in the purchase of commodities since he no longer possesses the defense of not having enough money. That sales resistance is reduced when the insufficient-funds defense is removed there can be no doubt.[3] One must be equally insistent, however, that it is difficult, if not impossi-

[1] Rolf Nugent and Leon Henderson ("Installment Selling and the Consumer," *Ann. Am. Acad. Political Social Sci.*, May, 1934, p. 95) state that in New York City, eight representative employers reported that 1,900 powers of attorney to collect wages were received in 1931 against their 105,000 employees. Practically all these demands for wages were by installment merchants; six jewelry and clothing merchants accounted for more than half of them. A street railway company employing 17,000 men reported that an average of 3,400 notices of assignment a year were received against its employees between 1921 and 1932. Armour and Company reported that among its 5,380 plant employees, most of whom are Negro laborers, the number of notices of assignments from 1921 to 1932 was approximately one-half of the number of employees.

[2] Nugent and Henderson, (*ibid.*, p. 97), report a case involving repossession of a car on which the last payment of $15 was due and for whose repossession a charge of $35 was demanded.

[3] Again quoting Nugent and Henderson (*ibid.*, p. 96), "A colored boy came into the Louisville Legal Aid Society for help because an installment company had attached the pay upon which his family's food depended. He was wearing a frightful purple checked suit, and we asked him how much he paid for it. 'Three dollars,' was his reply. Obviously this was the weekly payment, not the price . . . [The fact is] he had promised to pay $3 a week for thirteen weeks."

ble, to protect the consumer against his own poor judgment even though high-pressure sales methods were proscribed.

The third argument against installment selling is that the cost of financing is too high. According to figures appearing in one of the Twentieth Century Fund publications, interest charges on installment loans averaged about 15 per cent before the Second World War, or a yearly cost of 465 million dollars on 3.1 billion dollars outstanding.[1] Interest and service-charge rates under certain conditions are much higher than this, however. Though rates are unreasonably high in some instances, very often apparently excessive rates are not unreasonably high but are due to the necessity of meeting certain costs. These include:

1. Interest on borrowed funds.
2. Credit-investigation expense.
3. Expense of collecting on small notes.
4. Costs arising out of difficulties of repossession.
5. Losses on bad debts (ranging in a recent year from less than 1 per cent in the case of automobiles to over 7 per cent in clothing).

In general (and within limits) the rate paid by consumers is higher when (1) the balance due is small and (2) the time over which payments are made is short. The reason for this situation is simply that basic accounting and investigation functions must be borne even if the balance were but $1 and the time over which the payments to be made were but 1 week. The principle of increased rates accompanying small unpaid balances and short-contract periods is illustrated by the figures in Table 70. There are, then, certain conditions under which the consumer should avoid the use of installment credit. Cash payment should be made under such circumstances.

One must conclude then that, while installment credit is advantageous to the consumer in that it allows him to purchase better quality merchandise, forces him to save in kind, and makes possible more intelligent budgeting, it has certain undesirable features as well. Since racketeering practices exist in the field, the consumer should approach the problem of purchasing goods "on time" with caution. Moreover, installment charge rates under certain circumstances are more than many consumers can afford to pay. Probably the average consumer cannot afford to buy low-priced merchandise on the install-

[1] "Does Distribution Cost Too Much?" p. 237. Some concerns charge only ½ of 1 per cent per month on the balance due, with payment within 60 days considered as cash. One leading furniture store in Los Angeles has operated successfully on this basis for some years.

ment plan, since the rate for such service at times amounts to over 50 per cent per annum.

In any case, the consumer should know what rate he is paying for the credit service he is purchasing. This is important individually and socially. Without such information, in other words, the consumer cannot intelligently compare values among institutions, brands, or makes and cannot even intelligently decide whether to wait and pay cash or commit himself to a series of installment payments. Price

TABLE 70. RATE DIFFERENTIALS ILLUSTRATED BY THE CHARGES OF ONE OF THE LARGE AUTOMOBILE FINANCE COMPANIES*

Unpaid balance	Company charge	Monthly payments	12-month rate, per cent	Rates on less than 12-month contracts, per cent			
				10 months	8 months	6 months	4 months
$205	$18	$19	17	19	20	26	38
475	39	44	16	16	17	18	20
1,975	142	179	14	14	14	15	15

* Adapted from LEWIS A. FROMAN, The Cost of Installment Buying, *Harvard Business Rev.*, January, 1933, p. 230.

competition thus becomes quite ineffective since firms charging high rates are not forced to reduce them.

Consumers should be informed, not only of the true rate of charge for installment service, but also of the comparable charges of competing companies. "Until all consumer credit agencies adopt a common method of stating the rate of charge, the intelligent consumer who wishes to shop around for the best terms will have to resort to mathematics. . . . whether the commodity sold is money or mattress, the consumer is entitled to know the actual true rate he must pay for credit."[1]

Household Finance Company, author of the foregoing statement, has prepared a pamphlet on credit costs for the consumer, a major portion of which is composed of a table of true interest rates corresponding to cost ratios and the number of installments. From this table, one discovers that "for example, on a $100 loan, to be repaid in ten equal monthly installments with a deduction of 6% discount and 2% investigation fee, the true interest rate is not 6% or 8% but, as

[1] Mimeographed letter from Household Finance Company, 919 North Michigan Ave., Chicago, accompanying its pamphlet "How to Figure True Interest Rates on Loans and Installment Purchases."

the pamphlet shows, 1.55% per month or (even without compounding) 18.6% per year."[1]

One further phase of installment credit should be considered by the student of consumption economics. This concerns the effect of installment buying on cyclical business movements. One might think offhand that, since installment buying permits the purchase of merchandise by consumers who are not in possession of enough money to make an outright purchase, it would aid in cushioning the shock of depression conditions. This, however, is not true.

In general, installment buying probably has the effect of making for instability rather than for more stable conditions. The reason for this is quite clear. In good times, consumers have jobs and are optimistic about the future. Hence, they are willing to commit themselves to a series of monthly payments out of income. The result is that business becomes even more active momentarily (especially in durable-goods lines). To put it a little differently, boom conditions are intensified as a result of increased sales arising out of the optimistic attitude of buyers.

But when business activity slows up and optimism turns to pessimism (partly as a result of reduced wages and layoffs), consumers are unwilling to commit themselves to a series of future payments. Hence sales fall off and (particularly) durable-consumption-goods industries are hit very hard. Industries of this type expand rapidly in boom periods and thus receive a greater impact from cyclical downswings.

"Consumers' credit is not a device which enables consumers indefinitely to buy more than they could buy for cash. During the period while credit is in the process of expansion, consumers can buy more than they could for cash. But when credit is no longer expanding, even though it remains unimpaired, they cannot buy any more than they could if they could pay cash and did not have to use their cash to pay for things bought weeks before. When consumer credit begins to contract and as long as it is in the process of contraction, consumers cannot buy as much as they could if they had no debts to pay and could use their incomes in making cash purchases. This expansion and contraction of consumer credit makes for economic instability."[2]

9. Buying Superstitions. Many commodities—particularly food products—exist in a variety of qualities, and it is difficult to determine

[1] Household Finance Company, "How to Figure True Interest Rates on Loans and Installment Purchases."

[2] THOMAS NIXON CARVER, Consumer Credit and Economic Instability.

the proper quality of the particular article suitable for the individual family, even after the general purchase has been decided upon. The solution of this problem, as has been indicated, lies in the proper education of the consumer and in the working out and enforcement of proper standards by which the consumer may judge the true worth of the products that he buys.

At present, curious buying superstitions exist among consumers in different places. In connection with food, for example, there are a great many. In New York, consumers have paid higher prices for white eggs than for brown, whereas the reverse is true in Boston. Chemically, there is no significant difference between the two kinds of eggs. White bread is less nutritious than whole-wheat bread; yet there is a feeling that white bread is superior to whole-wheat bread. Rye bread indeed is considered even less respectable than whole-wheat. We find that the North demands yellow cornmeal, and the South desires white. Apples are customarily bought because they are red; some of the other varieties are equally good and much less expensive. The South wants yellow onions, but the North will take red ones too.

Certain cuts of meat are thought to be much better than others. The cheaper cuts, however, generally yield much more in calories per dollar than the higher priced cuts. As a matter of fact, many consumers are unable to judge the grades of meats they are purchasing and, in consequence, often receive poorer grades than those for which they have paid. "The policy of lowering the grades of meats sold at a time of rising wholesale market and of restoring the former grades on a declining wholesale market, thereby furnishing meats to customers at prices more nearly uniform than would be possible if the same grade were maintained constantly, is followed by many dealers and is regarded with approval by persons of high business standards in the trade. The shifting of grades is somewhat easier to those dealers who usually carry more than one grade. Carrying more than one grade also enables an unscrupulous dealer to sell meat of a lower grade to a customer who is unskilled in judging, at the same price as meat of a higher grade to a discriminating customer."[1]

Similar conditions prevail in other lines of expenditure. The sale of rayon, for example, was much retarded during the early years of its introduction because it was labeled *artificial silk* and consumers attached an idea of inferiority to it. Consumers can, in consequence, secure relative bargains, if they properly understand the qualities of

[1] "Retail Marketing of Meat," *U.S. Dept. Agr. Bull.* 1317, p. 31.

goods, by purchasing commodities that sell comparatively low in price because of these superstitions and avoiding those made comparatively high in price by them.

Prejudices, also, exist with respect to certain types of retail outlets. Some individuals penalize themselves by being susceptible to anti-chain-store propaganda. Others would not think of buying through the mail-order house. Still others feel it beneath their dignity to trade in basement establishments. Obviously, such prejudices are harmful to the consumer. The only way he can be assured of obtaining the best values is to keep well informed regarding offerings and to be willing to give his patronage to the institution offering the most for his money. A priori notions regarding certain types of institution tend to narrow the field of selection. Such a tendency is inconsistent with consumer-buying efficiency.

Closely allied to this sort of thing, perhaps, is the notion that one should demand the "genuine" in purchasing consumer goods—that "substitutes" are to be avoided by consumer-buyers. Actually, we think, one should assume quite the opposite attitude—one should experiment in purchasing and feel free to buy the articles which please, both from a quality standpoint and price-wise, regardless of the brand name. If an offering appears which seems to be a better buy than one which a person purchased before, the consumer should try it out if possible. Only by so doing will "brand monopolies" be kept from control and competition sharpened. In any case, by a process of experimentation the consumer may discover brands and makes which will deliver him an increased measure of satisfaction. To summarize: Consumer prejudices concerning types or brands of products or distribution methods adversely affect consumption efficiency; therefore prejudices should be replaced by an attitude of open-mindedness on the part of consumers.

Questions

1. Show that there are economic as well as technical factors involved in the proper designation of grades.

2. Would it be advantageous from the standpoint of the consumer to have a governmentally operated consumers' research organization?

3. Is the consumer's purchasing task more or less difficult than that of the industrial purchasing agent? Give reasons for your answer.

4. What are the most important elements making for efficiency in "buymanship"?

5. Considering both favorable and unfavorable aspects of installment selling, what should the policy of an enlightened commonwealth be in regard to it?

6. When consumers'-goods prices are rising, are scales of living affected inevitably? Scales of consumption?

7. Organize a consumer testing group in your class along the lines utilized by Dorcus and Jewett in their experiments (articles cited on p. 345), for testing consumer preferences for high-priced against low-priced candy, recording results and reporting findings to your instructor.

8. Considering existing institutions, what do you think is the future of grade labeling in the United States? Support your answer by objective data and sound reasoning.

9. Make a survey of consumer borrowing facilities in your community and the relative rates charged expressed in terms of simple interest on the balance due.

10. From the material in Table 69 and a study of the article from which the data were drawn, what types of merchandise are consumer-information agencies likely to be able to rate most accurately? Most inaccurately?

11. With the help of your retail butcher make a study of different cuts of meat and come to some approximation as to the comparative prices per usable pound.

CHAPTER XIX

CONSUMERS' COOPERATION

The consumers' cooperation movement, as conceived by its more enthusiastic supporters, embraces an entire economic and political philosophy. They see in it a means of reorganizing our economic structure and of eradicating many of the evils which are by-products of the capitalistic order. Chief among these would be the elimination of the profit motive as a stimulus to production and its accompanying evil, the desire to misbrand and adulterate goods. There also would be an elimination of high-pressure advertising and sales effort, which they argue would reduce marketing costs considerably. Many of the "unearned increments," then, would be the common property of society and would indirectly add to the incomes of all members of society. As a consequence, there would be a reduction in the disparity of real incomes.

Thus, rabid cooperators ". . . argue that if every ultimate consumer bought everything he used at a retail cooperative and received the accrued surplus back at the year's end in the form of rebates, there would obviously be no profit left in the retail trade. Manufacturers selling to the cooperative wholesales would, however, still be making a profit. But the wholesales could put an end to this by building their own factories. The end result would be that people would merely produce and perform services and receive produce and services in exchange. Capitalism would thus be subtly transformed into 'production for use,' a sort of glorified barter with money functioning solely as a medium of exchange."[1] As to the possibilities of such a program, the student should reserve judgment until he has well in mind not only the principles of consumers' cooperation but a conception of the extent of the movement in various parts of the world.

1. The Nature of Cooperation. Not all forms of joint effort are of the consumers' cooperative type. There are, chiefly in agriculture, a great many cooperative endeavors carried on by producers. These usually take the form of marketing organizations or processing plants to which producers bring their products and where such products are

[1] Consumer Cooperatives, *Fortune*, Mar., 1937, p. 144.

handled and sold by paid workers. Contrasted to this type of endeavor there are the so-called *cooperative workshops* which are actually owned and managed by the workers of such establishments. Nor are these the only types of cooperative activities in existence. The Report of the Inquiry on Cooperative Enterprise in Europe, 1937 (page 6), reveals that cooperative enterprise in Europe takes the following diverse forms:

1. Farmers' purchasing societies (for the purpose of supplying farmers' requirements of machinery, fuel, fertilizer, etc.).
2. Farmers' marketing societies (for the purpose of marketing farmers' products in an efficient and orderly fashion).
3. General-purpose farm societies (designed to receive and process commodities, sell such goods, and handle farm supplies and consumers' goods).
4. Workers' productive societies (groups of workmen owning and operating the enterprises in which they are employed).
5. Consumers' distributive societies (for the purpose of marketing consumers' goods).
6. Housing societies (whose purpose is to build and finance homes, often with aid of the government).
7. Utilities' cooperatives (for the purpose of building and operating telephone and power lines as well as that of buying or generating power to be sold to members).
8. Special service societies (for the purpose of supplying, say, burial and medical service for members).
9. Credit and banking societies (for the purpose of accepting and investing savings of members as well as that of borrowing money—sometimes from the government—to lend to members).
10. Insurance societies (for the purpose of writing life, accident, health, fire, livestock, and property-damage insurance for members on a mutual basis).

As can be seen, some of these cooperative organizations are primarily for the purpose of carrying on productive enterprises, while some are primarily for consumption purposes. There seem to be fundamental differences and conflict between consumers' cooperation and the other types of cooperative movements. Consumers' cooperation is essentially a social movement; it embraces all society. The aim of consumers' cooperation is to supply goods to its members at the most reasonable prices possible, to *save* the consumer money. The price relationship that is sought is essentially the relationship between the prices of the various commodities which the economist

would speak of as a normal price relationship. Producers' cooperation and cooperative workshops, on the other hand, would seem to be essentially capitalistic movements. The cooperators form a group with an individual interest opposed to that of the other groups in society. The interest of the group is that of obtaining a high price for its particular product relative to the prices of other products. That is to say, the main purpose of the producers' cooperative is to *make* money. The essential conflict between these forms of cooperations is not so readily apparent when they are small relative to other forms of social direction, but would of necessity appear if they increased materially in their importance.

2. Principles of Consumers' Cooperation. It is generally acknowledged that the cooperative movement as we know it today was inaugurated in 1844 by 28 flannel weavers, in Rochdale, England. Each contributed £1 toward the capital of the organization, and with this small sum a cooperative store was established. Ten years later, its membership had expanded to nearly a thousand and its yearly business amounted to considerably over £20,000. Consumers' societies vary in their organization but little from country to country, and whenever the movement has been successful, the principles evolved by the original Rochdale pioneers have been followed.

These principles, according to Dr. Warbasse,[1] one of the stanchest supporters of the consumers' cooperative movement, *evolved* from the school of experience and were not preconceived notions thought up on the spur of the moment. The contribution of the pioneers was that of selecting discriminatingly successful methods utilized by various cooperative societies and bringing them together in the form of a sound working plan. These principles are as follows:

1. *One Member, One Vote.* Each member is entitled to one vote regardless of the number of shares held. No proxies are allowed, which means that consumers' cooperation is founded on genuinely democratic principles. There are, of course, inequities arising out of the *one-vote principle*, since it allows no additional voice to those who contribute (*a*) more funds, (*b*) more patronage, or (*c*) more time and thought to the organization. Consumers' cooperation is a movement designed for the benefit of all, however, and the one-vote principle is fundamental.

2. *Limited Returns on Capital.* This provision has its purpose, that of limiting the rate of interest to the wages of capital. That is to

[1] JAMES PETER WARBASSE, Basic Principles of Cooperation, *Ann. Am. Acad. Political Social Sci.*, May, 1937, pp. 7–16.

say, the amount of interest paid should be only enough to draw capital into the enterprises. There should, in other words, be no element of profit in the return to capital. Speculation is thus eliminated and with it the type of individual who seeks to gain speculative profits from a successful enterprise. This, too, is a democratic principle.

3. *Sound Goods of Full Weight Sold on Cash Basis.* Though Dr. Warbasse does not specifically mention "sound goods of full weight" in his list of principles in the article cited, it is usually considered the *sine qua non* of consumers' cooperation.[1] Buying and selling for cash was laid down as a principle on the grounds that efficient merchandising demands adequate amounts of working capital and that if working capital is dissipated business cannot continue. Furthermore, it is argued that credit business is inequitable since those who are granted credit are carried by those who pay cash. And finally one of the original purposes of consumer cooperation was that of freeing people from debt. Why should the institution that is attempting a reform encourage a violation of one of its tenets? There are, of course, several exceptions to the general rule. The main one arises out of the sale of large items. In the purchase of houses, for example, the consumer is extended credit, often, however, through a credit union set up for the purpose.

4. *Distributive Savings Allocated for Definite Purposes.* In general the price policy of the consumer cooperative is that of selling at the market.[2] From the gross margin (the difference between cost of

[1] One writer (J. B. Mathews, The Cooperatives—An Experiment, *Atlantic Monthly,* Dec., 1936) devotes a great deal of space to a criticism of the quality of cooperative products and analyzes, among other things, the advertising claims of such British Cooperative Society products as health salt, sulphur tablets, yeast tablets, typewriter ribbons, and razor blades. He finds that representations made by the society are, to say the least, exaggerated and that the quality of some of the products is definitely inferior. One conclusion derived from the study (p. 710) is that "... *most* of the European cooperatives' medicinal products would have difficulty with the Federal Trade Commission or the Food and Drug Administration in the United States. The British Cooperative Pile Ointment ... carries the following plainly untruthful claim: 'If used as directed on the tube this Pile Ointment will not only be found effective in curing Piles, but also in preventing the conditions conducive to their return.' Such a claim has been illegal under the federal Food and Drugs act and in most of the states of the United States for thirty years." See also the discussion in Chap. 9 of L. C. Kercher, V. W. Kebker, and W. C. Leland, Jr.'s "Consumers' Cooperatives in the North Central States," on educating the consumer.

[2] Obviously, there are certain conditions that make it impossible or inadvisable to charge market prices for goods sold by cooperatives. Indeed, at times one is hard put to determine what the market price of a certain commodity actually

goods and selling price) are subtracted operating expenses, an amount (usually 2½ per cent) set aside for cooperative education, and a sum earmarked for reserve purposes. The resulting balance, if any, reverts to members on a basis of patronage; *e.g.*, a person making purchases amounting to 1 per cent of sales of the cooperative would be entitled to 1 per cent of the balance available for dividends. Hence those members responsible for the sales volume are given dividends in proportion to their patronage. Incidentally, patronage dividends amounting to more than $125,000,000 were returned to British members in 1936.

5. *Unlimited Membership.* Democracy is again promoted by an adherence to this principle. The one exception is that of keeping out those who might harm the society, *e.g.*, those who wish to use the society for purposes of individual advantage.

Three other operating practices have now earned a place on the list:

6. *Neutrality.* Because proponents of trade unionism, of socialism, or of some religious sect might destroy consumer cooperation by creating a schism in the ranks of the society, the neutrality principle has assumed a great deal of importance. Consumers' cooperation, it should be recalled, is a united effort on the part of consumers for the purpose of raising the scale of living. It is not designed to further the ends of any one faction.

7. *Education.* Since successful cooperation depends upon a clear understanding of the subject, all substantial societies put aside 2½ per cent of the surplus for this purpose. Educational activities take the form of lectures, pamphleteering, etc. And, since training is necessary for good management and training for profit business has been found to be inadequate for a successful execution of cooperative enterprise, courses for executives and employees are often offered also.

8. *Expansion and Union.* "When a group of people have learned how to supply themselves with one commodity, it would seem natural that they use the same methods and experience to supply other needs."[1] Moreover, a union of societies is rapidly becoming an international principle in order that societies requiring it can be given aid and competitive overlapping can be minimized.

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is. Moreover, in cases where the consumers' cooperative is attempting to break a monopolistic situation (such as those which obtained in Sweden for lamp bulbs, galoshes, and margarine) the invoking of the market-price rule would be ridiculous. In general, however, there is adherence to the rule if only to obviate a hostile attitude on the part of competitors and to induce nonmember customers to become members.

[1] Warbasse, *op. cit.*, p. 13.

As can be seen from the foregoing, the essential cooperative principles are democratic control, limited interest on capital, and saving returns in proportion to patronage. Unlimited membership, cash transactions, neutrality, etc., after years of cooperative experience have proved themselves, however, and as a result have been accepted as sound policies of consumers' cooperation.

Consumers' cooperation, then, differs greatly from ordinary profit enterprise. Consumers' cooperation is founded upon democratic principles. This is manifest in the membership policy, in the voting arrangements, and in the returns to participants. All are welcome to align themselves with the movement, each is given an equal voice, and everyone is granted an equal opportunity to earn participation dividends.

Private enterprise, on the other hand. is set up not for the benefit of the participants (customers) but for the stockholders. Indeed, in many instances private concerns are organized for the benefit of only a small group of stockholders. An attempt is made to maximize returns through monopolistic practices so that the beneficiaries may receive greater dividends. Control is exercised for the benefit of a minority group. Thus in private enterprise there is a fundamental conflict between patrons and enterprisers that does not exist in consumers' cooperation.[1]

3. Legal Organization of Consumers' Cooperatives. As has been suggested, consumers' cooperatives are quite different from ordinary corporate enterprises or such noncorporate types as partnerships. Indeed, the whole philosophy of the cooperative is in contrast with that of ordinary profit-making enterprise. One of the difficulties which is bound to be encountered by those setting up cooperative organizations is that, in the absence of special legislation which recognizes these differences, the courts may have to interpret the organization as being one of the orthodox types in cases of legal difficulty, to the tremendous disadvantage of the members.

"Cooperatives," says one student of the subject, "were begun at

[1] There might be some conflict between member-patrons and managers, however. For example, the typical consumers' cooperative enterprise is in competition with private enterprise. If the manager of the former is able to increase the business of the consumers' organization by selling goods of questionable quality because patrons (as a result of consumer ignorance) demand them, he may be granted higher managerial compensation. Indeed, since the consumers'-cooperative enterprise is faced with such aggressive competition, it probably has to offer goods actively in demand (whether of highest quality or not) or be faced with a situation of excessive distribution costs resulting from small volume.

first without any realization of the legal pitfalls surrounding an informal organization. [They might, for example, be considered partnerships by the courts with unlimited liability on the members.] When it became apparent that informal organization would lead to continuous difficulty in the courts, cooperatives, naturally enough, turned to the corporation for their legal garb. The difficulty of securing, under the general laws, the familiar Rochdale principles of organization soon led to the realization that the cooperative ought to be legally, as it is factually, a somewhat different institution from the regular corporate business enterprise.

"Since the time of the first statutory recognition of cooperatives—the first act was passed in Michigan in 1885—progress has been made toward filling in the outlines of a self-contained code of law for cooperatives, defining their nature by mandatory provisions, and permitting them leeway where the business corporation is restricted or restricting them where the business corporation is flexible. Along with this development there has been an increasing tendency to differentiate the consumers' cooperative from other forms of cooperation. The first assumption that cooperatives, whatever their functions, are all alike, has not been borne out. Later statutes usually recognize the important differences between the various types. The statutes that are on the books represent various stages of these two lines of development. They range from the relatively simple provisions of the Ohio law to the elaborate acts of New York, Wisconsin, and Minnesota.

"The laws, in general, cover one or more of the following points: scope and purpose; number who may organize; capital stock; stock ownership per member; distribution of earnings; required reports to a division of the state government; protection of the word 'cooperative'; and ownership of stock of other associations. It seems . . . that the important phases of cooperative law as it relates to the functions of consumers' cooperatives include the following: (1) status of the one-member–one-vote principle, including the no-proxy rule and voting by mail; (2) the status of interest on capital shares; (3) the methods of dividend distribution; and (4) the protection of the word 'cooperative' [so that the term cannot be utilized by spurious consumer organizations]."[1]

This is an interesting phase of consumers' cooperation which is worthy of further study.

[1] O. E. Burley, "The Consumers' Cooperative as a Distributive Agency," pp. 39–40.

4. Extent of Consumers' Cooperation. Total world cooperative membership is difficult to estimate. According to one recent article in a government periodical, "100 million consumers in 39 countries buy 33 billion dollars' worth of goods and services for distribution among themselves."[1] This, presumably, includes all kinds of cooperation—the transactions of cooperative banks and credit societies as well as those of the cooperative housing associations and of other cooperative enterprises outside the field of consumers'-goods retailing.

In many countries of Europe consumers' cooperation has attained tremendous strength. In such countries as France, Sweden, Finland, and Denmark, for example, consumers' cooperative societies are among the largest distributors of the necessities of life, particularly foodstuffs. The prewar figures given in Tables 71 and 72 indicate the extent of consumers' cooperation up to that time in Europe and in various European countries.

TABLE 71. COOPERATION IN EUROPE, 1939*

Type of society	Number	Membership	Type of society	Number	Membership
Agricultural......	188,000	22,000,000	Building.....	49,000	4,300,000
Consumer supply..	20,000	19,000,000	Housing.....	11,000	3,000,000
Artisans' producer.	20,000	5,000,000	Total.....	288,000	53,300,000

* JAMES PETER WARBASSE, "The Cooperative Way," p. 123. Barnes and Noble, 1946.

As can be seen, consumers' cooperation in Europe had made tremendous headway, particularly in certain countries. It has been able to make greater headway in some lines than in others, however. In England at the present day, for example, the proportion of total grocery sales passing through cooperatives is much greater than that of any other single item. As can be seen in Table 73, a very large per cent of certain staples and specialty items were purchased up to the war period through cooperative channels in certain countries. This appears to be still true, though postwar figures are unavailable. It should be noted that cooperative activity is spotty both in regard to the membership in various countries and in regard to patronage by merchandise lines.

Consumers' cooperative activity in transatlantic countries is of course not confined to retail trade. "The first expansion beyond retailing [in England] was taken in 1864, twenty years after the Rochdale weavers opened their pioneering store. In that year a

[1] USDA *Consumer Guide*, December, 1944, p. 8.

group of retail societies in Lancashire and Yorkshire joined together to establish their own wholesaling agency, which, after many early vicissitudes, is now firmly established as the Cooperative Wholesale Society. The C.W.S., as it is known throughout Great Britain, originally confined its business to wholesale merchanting.

TABLE 72. IMPORTANCE OF CONSUMERS' COOPERATIVES IN RELATION TO POPULATION JUST PRIOR TO THE SECOND WORLD WAR*

Country	Cooperators as per cent of population	Country	Cooperators as per cent of population
Consumers' cooperatives		Consumers' cooperatives	
Based on members only:		*(continued)*	
British Isles	18.1	Including families also:	
Denmark	10.0	Hungary	25.0
Finland	16.6	Netherlands	15.0
Germany	6.0	Norway	27.0
Latvia	1.4	Sweden	34.0
Lithuania	.9	Switzerland	25.0
Luxemburg	6.5	All types of association	
Netherlands	3.5	Based on members only:	
Norway	6.7†	Bulgaria	15.6
Rumania	.8	Norway	20.0
Soviet Union	32.1‡	Rumania	7.3
Spain	4.7	Including families also:	
Sweden	12.0	Estonia	50.0
Yugoslavia	1.6	Finland	50.0
Including families also:		Greece	20.0
Belgium	25.0	Hungary	45.0
Czechoslovakia	30.0	Poland	40.0
Denmark	33.3	Rumania	33.0
Germany	24.0	Yugoslavia	40.0

* "Cooperative Associations in Europe and Their Possibilities for Post-war Reconstruction," *U.S. Bur. Labor Statistics Bull.* 770, p. 25.

† Includes only associations affiliated to central organizations.

‡ Based on rural population; no consumers' cooperatives in urban areas.

As the movement grew in size and expanded its commercial activities, the C.W.S. was compelled to extend into other fields. It is now charged with the task of undertaking every kind of business involved in bringing salable articles to the retail store and in creating finished goods from raw materials. It undertakes the merchanting, manufacturing, importation, and transport of goods;

it undertakes banking, insurance, and the investment of cooperative funds; it is responsible for designing and building cooperative shops, factories, and warehouses; it owns farms and estates; it publishes books and periodicals; it conducts all kinds of consumer services—the pasteurization of milk, the administration of health insurance, provision of dental and optical treatment, and

TABLE 73. PROPORTION OF RETAIL TRADE DONE BY RETAIL COOPERATIVES JUST PRIOR TO SECOND WORLD WAR*

Country and type of trade	Cooperative business as per cent of retail trade	Country and type of trade	Cooperative business as per cent of retail trade
Belgium: Total retail trade	10.0	Latvia: Food	16.0
Bulgaria: Total retail trade	25.0	Lithuania:	
Czechoslovakia: total retail trade	3.8	Cement	59.5
Denmark: Total retail trade	17.0	Salt	76.0
Estonia: Total retail trade	24.0	Agricultural machinery	80.0
Finland: Total retail trade	30.0–40.0	Sugar	84.4
France: Groceries	6.0	Netherlands: groceries	6.0
Germany: Total retail trade:		Poland:	
1931	5.0	Total retail trade	3.0
1935	2.0	Food	10.0
Great Britain:†		Sweden:	
Food and tobacco	12.0	Total retail trade	12.0
Meat	14.5	Food	20.0
Coal	20.0	Switzerland:	
Sugar and preserves	27.0	Total retail trade	10.0–12.0
Hungary: Total retail trade	12.5	Sugar and macaroni	80.0

* *U.S. Bur. Labor Statistics Bull.* 770, p. 26.
† Data relate to 1942.

so on. On a smaller scale, the Scottish Cooperative Wholesale Society undertakes similar services for the retail societies in Scotland. . . .

". . . The Cooperative Wholesale Society and the Scottish Cooperative Wholesale Society jointly own and control two other federal societies: the English and Scottish Joint C.W.S. which conducts the movement's trade in tea, coffee, cocoa and chocolate, and owns tea plantations in India and Ceylon. . . . C.W.S. has 174

factories in different parts of England and Wales in which nearly every kind of domestic article is made, from aluminum ware to woolen cloth, from bacon to tobacco. It has warehouses and sales depots in most of the main urban centers. It employs nearly 60,000 workers. The Scottish C.W.S. has 56 factories with an aggregate output valued annually at over £6,000,000 and employs 13,000 workers. The total annual sales of the wholesale societies amount to £130,000,000."[1]

This certainly is an impressive record for consumers' cooperative development. Much of the same type of economic activity has been carried on by consumers' cooperatives in the continental countries.

5. Consumers' Cooperation in the United States. Consumers' cooperation has made relatively little headway in the United States, although it is much more important in some areas than others, as indicated by the data depicted in Fig. 17. While the percentage increase in sales volume during the depression was striking, the dollar volume in 1936 reached only the relatively insignificant figure of $500,000,000, or only about 1½ per cent of total retail sales. Furthermore, the business of the large farm purchasing cooperatives in the Dakotas, Wisconsin, Minnesota, Michigan, Kansas, Missouri, Indiana, Illinois, Ohio, Pennsylvania, and New York, is largely in oil and gas (for use, in part, in trucks and tractors), and in stock feed, fertilizer, seed, etc., which are likewise production goods. Probably three-quarters of the half-billion dollars of sales were made by farm purchasing associations. Most of the money spent in cooperatives, then, was spent in the interest of production for profit. "Consistent with the American character, consumer cooperation turns out to be, not a way of life, but a way of running the purchasing department of a business concern."[2] Data on the total number of associations, number of members, and the amount of business done by consumers' cooperatives in 1944 in the United States are given in Table 74.

The use of the consumers' organization for the purchase of production goods seems to be completely out of line with the aims of consumers' organization. Dr. Warbasse contends, however, that there is no fundamental difference between this use of the consumers' cooperative organization and that to which it is ordinarily put.

[1] George Darling, Consumers' Cooperation in Great Britain, *Ann. Am. Acad. Political Social Sci.*, May, 1937, pp. 161–162.

[2] *Fortune*, March, 1937, p. 144.

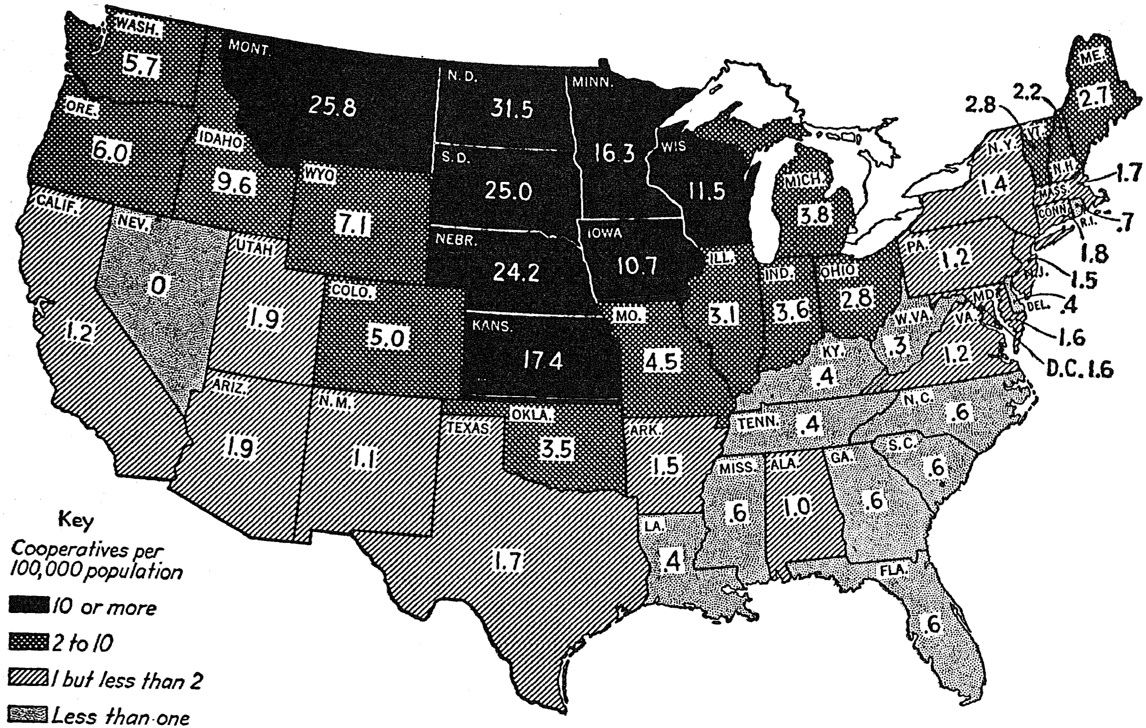

FIG. 17. Number of consumers' cooperatives per 100,000 population. (Source: "Cooperatives in the United States," Curtis Publishing Co., 1945, p. 5, which based the study on *Population*, Bureau of the Census, July, 1943, and *Cooperatives*, Directory of Consumers' Cooperatives in the U.S. as of Jan. 1, 1943, Bulletin #750, Bureau of Labor Statistics.)

TABLE 74. MEMBERSHIP AND BUSINESS OF CONSUMERS' COOPERATIVES IN THE UNITED STATES, 1944
(Local associations)

Type of association	Total number of associations (estimated)	Number of members (estimated)	Amount of business (estimated)
Retail distributive associations:	4,285	1,524,500	$557,000,000
Stores and buying clubs	2,810	690,000	280,000,000
Petroleum associations	1,425	810,000	270,000,000
Other distributive*	50	24,500	7,000,000
Service associations:	577	318,500	11,055,000
Rooms and/or meals	175	18,000	2,600,000
Housing	59	2,100	1,575,000†
Medical and/or hospital care:			
On contract	50	95,000	1,300,000
Own facilities	18	45,000	2,100,000
Burial:‡			
Own facilities	36	35,000	275,000
Caskets only	4	1,400	5,000
Other§	235	122,000	3,200,000
Electricity associations‖	850	1,149,700¶	60,960,000
Telephone associations**	5,000	330,000	5,485,000
Credit unions††	9,099	3,027,694	212,305,479
Insurance associations	2,000	10,510,000‡‡	190,000,000

* Such as dairies, creameries, bakeries, etc.
† Gross income.
‡ Local associations only; does not include associations of federated type (included with service federations) or funeral departments of store associations.
§ Such as cold-storage, water-supply, recreation, printing and publishing, etc., associations.
‖ Almost all of these are REA associations, data for which were supplied by the Rural Electrification Administration.
¶ Patrons.
** Data are for 1936; no information on which to base later estimate.
†† Actual figures, not an estimate.
‡‡ Policyholders.
SOURCE:
Curtis Publishing Company, *Cooperatives in the United States* (December, 1945), p. 13 from data published in the *Monthly Labor Review*, September, 1945, p. 468.

"The workingman patronizing his cooperative store, buying food and clothing [he argues], is supposed to be the real cooperative consumer. But as a matter of fact he is [in a sense] in profit business, just like the farmer. Instead of having commodities to sell, he has labor power to sell. And he wants to sell it at a profit. To increase the selling price he has his trade union, the same as the farmer has

his marketing association. But neither of these solves their problem. They both have their cooperative consumers' organizations. The workingman uses his to reduce the cost of the things he employs to produce the labor which he sells. Through his cooperative he gets the food to make his muscles go, the same as the farmer gets his gasoline to make his tractor go. The workingman puts clothing on his machine and houses it for its protection. He keeps down the cost of all this by the cooperative consumers' method and the more he succeeds in keeping down these costs the bigger is his profit when he sells his labor."[1]

However, there seems to be no gainsaying the fact that consumers' cooperation in its pure form has enjoyed relatively little success in the United States. There seems to be a combination of reasons for this lack of development. In view of the fact that consumers' cooperation offers many possible advantages to society,[2] one should find it profitable to inquire into the possible reasons for its retarded growth in America. This is particularly pertinent in view of the contrasting phenomenal success experienced by consumers' cooperation in European countries.

It should be continuously borne in mind that in many European countries consumers' cooperation is a way of life. Owing to an absence of economic frontiers there is no alternative but economically to utilize existing resources. Consumers' cooperation is aimed at reducing production and distribution costs in order to raise the level of life. In most European countries, homogeneity of population is the rule, so that consumers' cooperation not only is indicated but is practicable since the people are willing and able to work in a cooperative fashion. In the United States, on the other hand, the people are a heterogeneous lot. They differ not only as to race and religion but as to the geographical and climatic conditions under which they live. Hence, they are not nearly so cooperative-minded as their transatlantic cousins. Moreover, average earnings are higher in the United States, so that Americans do not feel so great a pressure on their pocketbooks for the basic necessities as do their European contemporaries.

[1] WARBASSE, *op. cit.*, p. 15.

[2] For example, reduction of prices through cooperative competition, improvement in merchandising efficiency, improvement in family economy (by discouraging overspending and encouraging cash buying and the maintenance of family budgets), improvement of quality of products, and the development of members' knowledge of economics and business.

As a corollary, in dynamic America—a country of tremendous natural resources—one has (or feels that one has) a good chance for individual economic improvement and can thus direct one's energies toward the earning of a higher income, rather than toward the conservation of a small income through more effective expenditures. The average American, in ordinary times, probably has little patience with an organization whose end is that of saving pennies.

There is in the United States, also, a more efficient system of retail distribution. "Consumer cooperation came into existence in Europe chiefly to protect homogeneous stable groups of workers of small income from an antiquated, inefficient system of retail distribution, which was free from Government regulation as to prices charged or character of goods sold and was supported by the doctrine of 'Caveat Emptor.'"[1] This means that there is not the same opportunity for gains arising out of consumers' cooperation in the United States as there is in countries where inefficiency prevails. Chain stores have developed with an increase in population mobility and are more firmly entrenched in the United States than ever before.

Consumers' cooperation in some countries acts as a "yardstick" by which the efficiency of distribution can be measured. Consumers' cooperatives, in such countries, assume a social responsibility regarding restrictive activities of private firms. In the United States, on the other hand, we have antitrust laws designed to restrain monopolistic control of business and enforce competition.[2] Food and drug laws, inspection and health laws, public utility regulations, etc., also have been provided in the United States. These, though somewhat imperfect, protect the consumer in some measure, at least.

[1] "Report of the Inquiry on Cooperative Enterprise in Europe," p. 110.

[2] One of the important factors of consumers' cooperative development in Sweden, for example, is success in curbing monopolies. Since the government is not concerned with the problem, the consumers' cooperatives are the only agencies giving fight to the trusts. Their efforts have been successful as regards the margarine, flour, galoshes, and electric-lamp-bulb monopolies. In each case, monopolistic prices were broken by the establishment of cooperative factories. According to Marquis Childs in his "Sweden—the Middle Way," the situation with respect to lamp bulbs was as follows: The industry was long controlled by an international trust. While the Luma (cooperative) plant was in the course of construction, the price of bulbs dropped from 37 to 27 cents. The Luma price was set at 22 cents which allowed a comfortable margin on which to work. So remarkable was Luma's success that when English cooperatives began *discussing* the possibility of a similar venture, the price of light bulbs in England promptly dropped 10 cents. See also Kercher, Kebker, and Leland, *op. cit.*, Chap. 10 on Meeting Monopoly and Monopolistic Competition.

Furthermore, we are continually and optimistically looking to *improved* consumer-protective legislation. The people of the United States, in other words, have been looking to government for protection, rather than to cooperative effort.

One other reason for the lack of success of consumers' cooperation in the United States is that the movement has failed to draw and retain outstanding managerial talent. Probably one of the reasons is that American private business offers such tremendous premium for good management. Wages of executive talent are so much greater in private business than in consumers' cooperation that outstanding executive brains are drawn to capitalistic enterprise. This makes for a condition that might be termed *a survival of the unfit* in cooperative enterprise. This weakness might be overcome in time if the importance of the psychic income arising out of cooperative endeavor can be instilled in the minds of young and talented leaders.

Consumers' cooperation has never been able to gain a firm foothold in the United States and, hence, has not had the advantage of a large and efficient wholesale business behind it. Full gains cannot be realized without such an organization. Cooperative enterprise has been given little encouragement by private business; in fact, private firms have actually made it difficult for cooperatives. The absence of a wholesale organization, incidentally, makes for a vicious circle in that without it top efficiency is impossible; hence, savings are insufficient to induce patronage. Moreover, without a large volume of business (resulting from such patronage) a wholesale organization cannot be maintained.

6. Critical Evaluation of Consumers' Cooperation. Consumers' cooperation is to be contrasted in its aims and methods with socialism. Socialism, in general, is a political movement. It aims to overthrow the present order and to substitute for it another in which the main means of production are publicly owned and directed by government officials. There would be a centralization of authority and control from above. Many socialists advocate that the change be made quickly and at once. Consumers' cooperation, on the contrary, is essentially a democratic economic movement. It seeks to direct society not by means of political vote, but by the economic interests of the consumer. The control is decentralized, resting in the consumers themselves and passing upward. It hopes to achieve its end not at once or violently, but by a gradual expansion through the various fields that are devoted to ordinary profit-making business.

As to the relative efficiency of consumers' cooperation and private business, few conclusive statements can be made. There is some indication, however, that the well-managed cooperative enjoying active consumer support has some advantages with respect to operating costs in actual practice. For example: (1) Salaries and wages might be lower as a per cent of sales owing to donated time, high sales per sales clerk (owing to short business hours), and bulk sales of fast-moving items. (2) Rents might be lower, owing to the fact that best locations need not be utilized since members might be induced to go a considerable distance to trade in their own establishment. (3) Advertising might be a less costly item owing to the fact that less costly forms of publicity (such as lectures and pamphlets) may be utilized; that, in any case, volunteers often carry on some of these activities; and that cooperative effort is in part parasitic, in that private manufacturers create a demand for a certain type of product (corn flakes, say) and cooperatives supply the demand so created. (4) Capital costs are often low owing to the fact that those who furnish it do so on a much less rational basis than those furnishing capital for private enterprise. (5) Credit losses are much less than those of many private concerns since credit service is not ordinarily extended. Other service costs are also reduced since patrons are often willing to carry some of the marketing burdens themselves.

Obviously, many of these so-called advantages would disappear in a society dominated by a cooperative system. Even granting the aforementioned advantages, however, the lot of consumers' cooperation is far from happy in the United States. Many cooperatives have been unsuccessful and have failed; some have been sold out to private persons, or have had to be reorganized. The main causes of lack of success seem to have been:

1. Poor or dishonest management (including bad bookkeeping, lack of proper audits, etc.).
2. Inadequate capital.
3. Credit extension.
4. Attempts at underselling private traders.
5. Declaring dividends too soon.
6. Lack of patronage or support of members.

These causes resolve themselves into (1) poor management, (2) a lack of adherence to fundamental cooperative principles, and (3) an absence of cooperative spirit within the membership.

As to the prospects of consumers' cooperation, it must be admitted that the movement contains many elements of strength

although its expansion is likely to continue to be more rapid in Europe than in the United States. It is quite probable, moreover, that it will become relatively a much more important form of economic activity than at present. There are, however, certain inherent weaknesses in consumers' cooperation that will prevent it from entirely dominating the economic system. Cooperatives now customarily accept the market level of prices and price their goods accordingly, remitting to their members savings in the form of dividends. If consumers' cooperation were the exclusive system, then these prices would not exist, and there would be the difficult problem of determining the proper amount and type of goods to produce and the prices of such goods. Moreover, the cooperative is usually a follower rather than a leader in the development of new desires, and as long as there were no legal prohibition we would expect to find always a more or less wide group of businessmen developing new things.

The consumers' cooperative also faces problems in its relations to its employees. As long as there are more or less definite wage rates established in the competitive market and the cooperative consumes principally things that are not produced by its members, the problem is not serious; but if the cooperative absorbs the market and its goods are made principally by its own members for sale to it alone, these problems become vital. There will, in other words, be constantly a demand for better pay and working conditions advanced by the employees as a claim against the general profits of the organization. This has actually occurred with some of the larger cooperatives. This is, indeed, a clear conflict of interest and one that would necessarily arise if the movement were to take the place of the existing system. It is the opinion of the authors that while consumers' cooperation admittedly has a broad field, this field is not without limits and the consumers' cooperative movement cannot be expected to expand sufficiently to dominate the economic order completely.

Questions

1. Distinguish specifically the consumers' cooperative organization and the ordinary business corporation.

2. What are the three most important reasons for the success of consumers' cooperation in Europe and its absence of success in the United States?

3. Are there any *real* economic advantages resulting from consumers' cooperation? Must one have a specific country in mind in order to answer the question intelligently?

4. How do you account for the comparative success of cooperative oil associations and the failure of cooperative retail stores?

5. Compare and contrast the principles and ends of consumers' and producers' cooperation.

6. Visit a consumer cooperative in your area and write a brief report on the methods utilized and the success experienced in this operation.

7. Check with the attorney general of your state as to the type of special cooperation laws which are provided for organizing consumers' cooperatives. What would be the objection to merely organizing informally without benefit of state laws? On the other hand, why not organize under general corporation laws?

8. Check on the tax situation, both state and Federal, as it affects consumers' cooperatives; particularly sales and chain-store tax measures.

9. How do the Fair Trade laws discussed in another chapter affect the operation of consumers' cooperatives, if at all?

10. Credit unions differ from consumers' cooperatives in at least three important particulars—membership restrictions, price policies, and distribution of net income. How are these differences explained?

11. What has been the trend of growth of credit unions in the United States during the past two decades or so?*

* See Lincoln Clark, "Credit Unions in the United States," *Journal of Business of the University of Chicago*, October, 1943, p. 235.

CHAPTER XX

THE POPULATION PROBLEM AND THE CONSUMER

The relation of the number of people to the product of society is an important problem. It is, in many aspects, largely a consumption problem, since the population that a given area supports depends in a large measure upon the consumption habits of the people. Among plants and animals, the numbers are determined principally by the needs of subsistence. There is a strong tendency for a rapid increase in numbers until the population becomes so large that nature thins out the young before they reach maturity and the population becomes stationary. With mankind, these forces are complicated by considerations of the future that lead many to restrain their impulses and by influences that society throws about the individual. These act sometimes to increase and sometimes to decrease the growth of population.[1]

1. Factors of the Problem. The population problem, at least for the Western world, is a dynamic one. The number of people is increasing, the product of society is increasing, and the consumption of the people is changing. There are, in consequence, three important aspects of the problem: (1) the rate of increase of the people, (2) the rate of increase of production, and (3) the changes in the consumption of the people. These are mutually dependent factors, a change in one necessarily affecting the others. Thus, in a settled community, an increase in the number of the people at a more rapid rate than the rate of increase of production can be accomplished only with a downward revision of the level of consumption of the people. Similarly, an increase in the level of consumption means that the rate of increase of the people will necessarily become relatively slower than the rate of increase of production. A uniform level of consumption means that the rate of increase of production is just equaling the rate of increase of the people. These situations may be temporarily obscured by the accumulation or depletion of wealth produced but unconsumed by the people. This, however, will be temporary, and in the long run the relations that we have indicated will hold true.

[1] See A. Marshall, "Principles of Economics," 8th ed., p. 173.

2. The Growth of Population. The world's population has increased rapidly during the last three centuries. It has increased fourfold since the middle of the seventeenth century and has doubled since 1800. It still continues to increase. Such a rapid and prolonged growth cannot have occurred previously in the world's history or our present population would be many times greater.

The present rate of growth and the prospects for a continuation of growth differ markedly in various sections of the world. In North America, areas of Europe, and in some of the areas with cultures analogous to those of European populations, future growth is expected to be slow and perhaps population may even decline. In the less fully developed areas of eastern Europe, the Soviet Union, and Japan declines in fertility were evident prior to the war but had not overtaken the declines in mortality and in consequence growth is still rapid. Nevertheless the factors ultimately slowing the rate of growth were evident in these areas. In virtually all the technologically undeveloped regions of the world both birth and death rates are high and the growth potential is, in consequence, large. Application of the established techniques for the reduction of mortality could lead to a very rapid growth unless lack of food holds population down. Areas differ in this respect. In large portions of South America, Africa, and the Middle East developments fostering a larger population would probably be accompanied by an increase in production sufficient to maintain the old level of consumption or perhaps raise the level of consumption for a considerable period of time. But in the densely settled areas of Egypt, India, China, Korea, Formosa, Java, and much of the Caribbean the high growth potentials are present with an already dense population. In fact, the pressure of population is so great in these regions that technical advances in production appear likely to be swallowed up by an immediate increase of population. The result would be simply more people maintained on the subsistence level. The problems of these areas are thus important, not only to the areas themselves, but to the rest of the world as well. They may become potential danger spots for new wars, if their peoples seek an outlet for their excess population by force. They also raise problems of the desirability and nature of relief activities to be undertaken in their behalf.

In the United States there are three principal features that characterize the growth of population: (1) The decline in the rate of growth of the total population. The decennial rate of increase has fallen

since about 1860, and the annual increase in numbers has fallen since 1923. (2) Our increasing urbanization. In 1900, 27 per cent of the total population lived in places of 10,000 or more, whereas in 1940 48 per cent lived in places of this size. (3) The marked differential between the rate of growth of the various social and economic classes. Lorimer and Osborn report that there is hardly a single urban group in which the majority of the young people enjoy the advantages of a high-school education, and in which many continue their education through college, that is now replacing itself from one generation to another.[1]

The probable population of the United States at certain dates in the future has been estimated by several investigators. The estimates of Reed and Pearl based on extrapolation of an S-shaped growth curve to the past population indicate a maximum population of around 200 million about the year 2000. Estimates by Dublin, Whelpton, and Thompson based on estimated birth rates, death rates, and immigration place the peaks earlier and the maximum lower, ranging from 148 million in 1970 to 190 million in 1980.[2] Industries such as agriculture, which depend to a great extent upon population for an increasing demand, will face increasingly difficult problems of adjustment. In most lines, however, readjustment will not be difficult once business is convinced that population growth will slacken and is able to make estimates accordingly, since the changes will be gradual. Somewhat more important in its effect on demand is likely to be the changing age composition of the population. The proportion of young people in a stationary or declining population is much less than in a growing population. Estimates of the age composition at different periods are shown in Table 75.

Such changes must necessarily alter demand for things like educational facilities, recreation, and clothing. They will undoubtedly lead to increased pressure for public responsibility for the aged and to agitation for larger families.

We are becoming increasingly an urban people. It is estimated that fully one-half of the people in this country now live within an hour's automobile journey of a city of 100,000 or more.[3] Three-quarters of the national increase in population between 1920 and

[1] F. Lorimer and F. Osborn, "Dynamics of Population," p. 199.

[2] See O. E. Baker and T. B. Manney, "Population Trends and the National Welfare," U.S. Dept. of Agriculture, Bureau of Agricultural Economics.

[3] "Recent Social Trends in the United States," Chap. 9, The Rise of Metropolitan Communities, p. 493.

TABLE 75. ESTIMATED PROPORTION OF POPULATION IN VARIOUS AGE GROUPS*

Ages	1880	1930	1980
Under 5	13.8	9.3	6.4
5–19	34.3	29.5	20.3
20–44	35.9	38.3	35.4
45–64	12.6	17.5	25.8
Over 65	3.4	5.4	12.1

* W. S. THOMPSON and P. K. WHELPTON, "Population Trends in the United States," p. 415.

1930 took place within the orbits of these large cities. The census classification of localities as urban and rural with all places having a population of 2,500 and over classified as urban is becoming increasingly less significant. Nevertheless, in 1900 the census reported 60 per cent of the people as living in rural areas and but 44 per cent in 1940. Much of this change was accomplished by migration from the country to the city in search of larger opportunities. The depression years following 1930 saw a reversal of these trends, but they became operative again as times improved.

The increase in population does not come equally from all classes of society. A great difference exists among the birth rates of the various social and economic classes. The higher birth rates are to some extent offset by higher death rates, but not sufficiently to overcome the difference in birth rate. It is a well-recognized phenomenon that, as we descend the social and economic scale, both the birth rate and the mortality rate increase. An example is given in Table 76, where monthly rental value of the home is taken as an indication of the economic status of the family.

TABLE 76. ALL CHILDREN BORN PER MARRIED WOMAN AGED 45–54 YEARS IN THE UNITED STATES, 1940*

Monthly Rental Value of Home	Children Ever Born
Less than $5	4.8
$5–$9	4.2
10–14	3.6
15–19	3.2
20–29	2.8
30–39	2.4
40–49	2.2
50–74	2.0
75–99	2.0
100 and over	2.0

* "Statistical Abstract of the United States, 1946," p. 56.

The differential rate of growth among classes raises the important problem of whether the general inborn qualities of the people are decreasing. Certain groups in the upper and middle classes are not maintaining themselves, and the great increase is coming from the lower social and economic groups.

"The only groups in the United States which are at present reproducing at rates far above actual replacement needs are located in certain rural areas, and predominantly in communities that are at the lowest economic levels and most remote from those educational and cultural influences which are held typical of social progress in this country. And within the towns and cities, the lower occupational groups, especially those in marginal economic circumstances, and dependent groups, characterized by low ratings as regards cultural-intellectual development, are commonly found to have birth rates somewhat above replacement needs and far above the birth rates characteristic of neighboring groups with superior advantages."[1]

On the assumption that there is a considerable correlation between the possession of a low income and "poor" qualities and a high income and "good" qualities and that these qualities are hereditary, then the general quality of the population must be lowered progressively.[2] Certain things must not, however, be overlooked in reaching a conclusion on these points. The first is that the test of economic position may not be an entirely valid one. It is within the power of each society to reward liberally those members whom it judges to contribute most to that society. It is possible that the system of rewards in our present organization does not sufficiently repay those making the most lasting contributions to our civilization.[3] In the second place, these differences are undoubtedly due

[1] LORIMER and OSBORN, *op. cit.*, p. 199.

[2] *Ibid.*, p. 175: "There are marked differences between occupational groups in their cultural-intellectual development as measured by intelligence tests. A great number of studies have been made on this subject, and with few exceptions the results obtained are extraordinarily consistent. The studies often show a difference of twenty or twenty-five points in average intelligence quotient between the uppermost and lowest of five main occupational groups. Classification by income, or by other indices of social status, usually yields somewhat similar results.

"There is much overlapping of individual abilities among all social classes. Nevertheless, the relatively high frequency of persons of unusual ability in the upper social groups and the relatively high proportion of mental defectives or persons with very inferior intellectual development in the lowest social groups is one of the striking results indicated in the survey."

[3] MARSHALL, *op. cit.*, p. 598: "Many business men, whose inventions have in the long run been of almost priceless value to the world, have earned even less

in a large measure to environmental and educational advantages. Though the precise part played by environment and heredity is incapable of differentiation, the environmental factor is undoubtedly large. The effects of these environments are inherited in a large measure, similar to the inheritance of hereditary characteristics.[1] Moreover, they are cumulative in their effects. If the environment of this generation can be improved, then the individuals are better than they would have been had they lived in a poorer environment. They, in turn, will be able to provide their children with a superior environment, and these, in turn, their children, etc. We may conclude, therefore, that, even though the innate quality of the people may have declined slightly, and this is indeed open to serious question, this decline has certainly been much more than offset through improved environment. We also find a clear tendency for the rate of increase of a class to decrease as its material well-being increases. If the rate of decrease itself decreases as material well-being increases, then, as society increases its per capita income, its distribution remaining the same, the relative increase of numbers coming from the lower income groups would decrease. We may also definitely conclude that any less unequal distribution of income because of a relative increase in the income of the lower income groups must lower the proportion of the population coming from the lower income groups.

3. The Rate of Increase in Production. The principal difficulty that arises in the case of production as population becomes larger is the general tendency toward diminishing returns. The broadest statement of this tendency is the so-called *classical law of diminishing returns;* viz., that an increase in the capital and labor applied to land causes, *in general,* a less than proportionate increase in the amount of produce raised, unless it happens to coincide with an improvement in the arts in agriculture.[2] The reasons for this general tendency are that, as more products are obtained from the land cultivated already, the increased production can be obtained only

by their discoveries than Milton by his 'Paradise Lost' or Millet by his 'Angelus'; and while many men have amassed great wealth by good fortune, rather than by exceptional ability in the performance of public services of high importance, it is probable that those business men who have pioneered new paths have often conferred on society benefits out of all proportion to their own gains, even though they have died millionaires."

[1] See A. C. Pigou, "Economics of Welfare," 1st ed., pp. 98–101.

[2] Marshall, *op. cit.*, pp. 407–409.

at a greater cost of labor and capital per unit of product and that the cultivation of new land necessitates the utilization of poorer land. If it were not for improvements, then, we would find shortly that an increase of population could be obtained only at the expense of a lower level of consumption.

There are a number of factors that tend to offset this tendency toward a diminishing return. The development of productive technique and the discovery of new natural resources are important ones. They have been principally responsible for our great increase in productiveness during the past century and a half. It is a problem of how long this march of progress can continue. No one can predict. There are, however, two good reasons for supposing that it cannot continue indefinitely. The inventions and discoveries that have been effective in increasing production are those that make available new natural resources hitherto unused or that provide a better utilization of those already in use. Thus, the steam engine substituted the energy in coal for the muscular energy of man and horse, and the hydroelectric turbine more effectively utilized the energy in the streams and rivers than the old water wheel. If there is a definite quantity of those resources, the discovery and utilization of each lessens the probability of future discoveries. Furthermore, improvements become increasingly difficult as the machine in use becomes more effective. It is much easier, for example, to raise the efficiency of utilization of coal from 5 to 15 per cent than to raise it from 15 to 25 per cent, each an addition of 10. This indicates increasing difficulties of expansion along these lines.

Another factor that lessens the sharpness of the action of diminishing returns is the advantage that a large population gains from large-scale production and specialization.[1] These advantages are quite considerable and have offset the action of diminishing returns for a considerable time in many places. They operate most markedly, however, in the early stages of a community's development and gradually lose their force as population becomes more dense. Although they offset, in part, the action of diminishing returns, they cannot be expected to do so completely.

Total production may be increased also by a growth in the amount of capital. If the rate of increase in capital is greater than the rate

[1] Henry George and Simon Patten have argued that this might completely overcome the tendency to a diminishing return. See Henry George, "Progress and Poverty," Book II, Chap. IV.

of increase in population, then each laborer will have more capital to work with than formerly and the per capita product will be increased. There has been a growing accumulation of capital in the world during the past century and a half, and this is a factor we may expect to become increasingly important, since incomes appear to be rising and greater portions of large incomes are likely to be saved than of small incomes.

There is, in addition, the possibility of increased efficiency in our utilization of human resources. A large portion of our increase in production was due to the greater trustworthiness of modern workmen as compared with old. Moreover, any population contains a large number who contribute little to the productiveness of society. A reduction of this proportion would add to the per capita production. Similarly, there are indications of untold resources in the way of human energy in the great spurt of production following the introduction of piece rates in many industrial establishments and the impetus to production in the First World War. Methods that sustain the interest and enthusiasm of the workers would do much to increase production.

In the United States we find, as yet, no clear evidence of the action of the general tendency toward diminishing returns. The rate of increase in our production has been greater than the rate of increase in our population, and we have had, in consequence, a continual rise in the level of consumption. Data on the rate of increase of our total production are not very satisfactory, but indexes prepared by several separate investigators show nearly identical rates of increase over a considerable period of years.[1] Burns concludes, " . . . if there has been any decline in the rate of growth in the total physical production of this country, its extent has probably been slight, and it is even mildly probable that the rate of growth may have been increasing somewhat."[2] The principal increases in production have come from mining and from manufacture. Agriculture has about maintained pace with population growth, manufacturing has increased about twice as rapidly, and mining about three times as fast.

4. Changes in Consuming Habit. Over broad sections of the world, certainly in considerable areas of Europe and the United States, food is no longer the principal factor limiting population.

[1] The Day-Persons index shows an average annual growth of 3.7 per cent during 1870–1930 and the Warren-Pearson index a rate of 3.8 per cent.

[2] Arthur F. Burns, "Production Trends in the United States since 1870," p. 279.

In Africa and Asia, food continues to hold the dominant role, and the great mass of the people is close to a bare subsistence level. The almost universally declining birth rates in the Western countries are ample evidence that new economic and psychological forces are at work. The emphasis of discussions on population has as a result been shifted from a consideration of factors limiting or determining the maximum population to a consideration of the optimum population.

There is no agreement as to what constitutes an optimum population. It depends upon the objectives of the group. For example, is the optimum for the individual or for the state? The state is a collection of individuals, but not only of present individuals but future individuals as well. What is best for those today may not be best for the long-run interests of the state itself. Is the state to be a self-contained economic entity or to function in a world of free trade? If war is imminent, then a large population with consequent supply of available troops may be desired, even at the expense of a low level of consumption and poor quality of population. For an isolated country, where the danger of war is less, the ideal would seem to be a population of such size that with some chosen division of the day between work and leisure available production resources would be worked at the point of maximum sustained per capita output.

Levels of consumption are frequently compared on the basis of their cost or the quantity of goods included in them.[1] A high level in these terms means one that has a high cost or includes a large quantity of goods, and a low level, one that has a low cost or includes small quantities of goods. These concepts are useful when we are dealing with economic welfare, since we usually may associate a high level of consumption with large per capita welfare and a low level of consumption with low per capita welfare. They do not, however, constitute the best levels of consumption when considered from the standpoint of the material progress of the nation. From the standpoint of material progress, that standard is most effective which produces the largest surplus—not total surplus, but surplus relative to the amount consumed. Thus, a high level of consumption that produced a given surplus would be less efficient than a low level of consumption that produced a smaller surplus if the production relative to the consumption on the lower level were larger.

[1] See T. N. Carver, "Principles of Political Economy," Chaps. XXXIX and XLII.

This, of course, omits any consideration of well-being, but in the absence of evidence to the contrary we must assume that a relatively high well-being accompanies relatively large material possessions.

The nation whose production exceeds its consumption progresses in an economic sense, whereas that whose consumption exceeds its production declines. This surplus will be greatest in any given nation with a given population when all consume so that the ratio of their production to their consumption is greatest. Production must be taken in the broadest sense. Many do not produce directly but act as the advisers or inspirers of others and in this way increase total production. Such people must be judged productive even though it may be difficult to isolate precisely their specific contribution. Similarly, we must judge a person by his entire life, rather than by a single period of it. The consumption of a child and of those who are receiving specialized training usually exceeds their production but may be more than justified by the subsequent large surplus that they produce. Moreover, we must, for this purpose, adopt a material and ethical view of production and deem as production only those things which directly or indirectly result in material production.[1] Thus, the services of the educator or physician might be deemed productive since they enable others to increase the material product of society, but the activities of the robber or the purveyor of "fake" medicine could not be judged so.

Much of the validity of this test of an efficient standard rests upon the assumption that these accumulated surpluses of capital will increase subsequent production. It is a general principle of economics that a relative increase of any one factor of production reacts to the benefit of all the other factors and increases their productivity.[2] This will lead directly to a rising level of consumption. Because of the increase in capital, each laborer is now able to produce more in the community than he would have been able to produce if the quantity of capital had been smaller. This means that it is now possible to

[1] Development of the opposite viewpoint may be found in H. J. Davenport's "The Economics of Enterprise," Chap. IX.

[2] See Pigou, *op. cit.*, Part V, Chap. III.

P. H. Douglas ("Theory of Wages," p. 487) says, "During the period from 1890 to 1922, an increase of one per cent in the quantity of labor in manufacturing in the United States, with the quantity of capital constant, would normally lead to an increase of three-fourths of one per cent in physical product. During this same period, an increase of one per cent in the quantity of capital in manufacturing, with labor constant, would normally lead to an increase of one-quarter of one per cent in physical product."

satisfy wants that were formerly relatively unimportant since they added little to men's ability to produce. But now, both because the productive cost of supplying these wants has decreased and because the greater productivity of laborers made possible by capital accumulations has made each increase of production, owing to the inclusion of a previously excluded good, larger than it was before, there will be a constantly rising level of consumption necessary in the fulfillment of an efficient level of consumption.

There is a constant battle waged among classes, nations, and races on the basis of their levels of consumption. Those on low levels seem to multiply faster and crowd out those on the higher levels by figurately eating them out of house and home. In one portion of Texas, for example, the whites were crowded out by the lower level blacks, and subsequently the Negroes by the still lower level Mexican peons. The real competing power of a level of consumption, however, depends not on whether it is high, but on whether it is more efficient. If people are proportionately more efficient in their production than they are in the amount of their consumption, then they can hold their own against the lower level group indefinitely. It is not the low level of consumption that is invariably successful, but the efficient level, which may be either high or low. As population increases, unless it coincides with a change in the arts of production or with a great accumulation of capital, there will be a diminishing productivity per capita. If this decrease of productivity is proportional on all levels of consumption, then the competing power of those who show the greatest excess of production over consumption relative to their consumption will be increased regardless of the actual level of consumption. The final test of the competing power of a level of consumption lies neither in the absolute level of the consumption nor in the present excess of production over the present level of consumption, but in the excess of production relative to consumption, and that group must win whose proportion is the greatest.

Countries peopled by races with high levels of consumption sometimes raise barriers against the competition of those with lower but more efficient levels of consumption. The latter with their more efficient living would shortly be able to buy out the farms and industries of the original inhabitants. Thus we have immigration restrictions in this country and the practical exclusion of certain peoples. The problem is not, however, entirely solved by this exclusion but is transferred to another field. Competition between nations proceeds in the markets of the world and is just as real and bitter as competition

between individuals; it proceeds more slowly but just as surely. The nation with the more efficient consumption must eventually drive the less efficient from the markets of the world. Wars and invasion may result when the pressure becomes great enough. Superior natural resources will give a particular people an advantage for a time, but some of these resources must finally be exhausted and with the exhaustion comes the severe handicap of a more costly level of consumption. There is, however, considerable point in excluding those with effective competing levels from entry into a particular country. If the population is kept small relative to the natural resources and capital of a country, then the per capita production will be high, and a high level of consumption may still remain an efficient one. It may be more efficient than that of the worker in the other country solely because the natural resources and capital that country provides are relatively small. Thus, we practically prohibit the immigration of the Chinese to this country as their low level of consumption is relatively very efficient when they are able to work with the large amount of capital and natural resources that we have relative to China. As long, however, as the Chinese working in his own country must compete with the American laborer working here, his production, because of the scarcity of natural resources and capital, will be so low that his level of consumption will not be so efficient as that of the American laborer, and we need have no fear of his competition.

In considering the consumption of a people in relation to their production, it is necessary to recognize two portions, that which is essential in maintaining their health and efficiency and that which is not. We may designate the first as the *level of life*. An increase in the level of life implies an increase in self-respect and energy, a more careful judgment in expenditure, and an avoidance of goods and activities that are unwholesome. We may designate the second as the *level of comfort*.[1] It includes those things which, while they add much to the enjoyment of life, do not add to, or may even detract from, our productive powers. A rise in either the level of life or the level of comfort will increase the product of the workers, but at different times and in a different manner. An increase in the level of life will increase the productivity of the workers and, in consequence, their wages and the total product of society. The laborers themselves and others of society gain. An increase in the level of comfort, on the other hand, will raise the earnings of the laborers only through its effect upon their numbers. This cannot come immediately but must come through

[1] See MARSHALL, *op. cit.*, pp. 689–690.

the smaller size of the subsequent generation. This will increase the product per laborer and his wage; but the decrease in numbers will more than offset the increased productivity, the total product of society will be smaller, and other classes will lose. Thus a rising level of consumption may or may not increase the total product of society and may or may not benefit other groups. Moreover, it does not necessarily follow that, because a population is small, it will have an efficient level of consumption, but simply that the level of consumption may be higher than if the population is large. When the level of consumption is close to the level of life, it is efficient, and, as the level becomes increasingly a comfort level, it becomes more inefficient the higher the level.

Questions

1. What is meant by the statement, "The population is growing older"? Does such a tendency have a bearing on the rate of population growth? What other factors enter into the tendency toward population stability?

2. In the December, 1946, issue of *Fortune* there is an article on our aging population. Consider the effect of an aging population on consumption in general terms. Would the food requirements of a city having a high average age be materially different from one having a low average age?

3. What industries are likely to feel the decline in the rate of population growth the earliest? Which may be affected ultimately?

4. Certain types of businesses and industries bear a close relationship to the population in a community; others show little association. Give examples of the two types.

5. What notable differences occur as to age distribution among the urban and rural-farm population? What are some of the educational implications in this connection?

6. Does the American laboring man have any concern with the level of consumption of the laboring class in other countries?

7. If a mechanical cotton picker should lessen materially the demand for the hand labor of the Negro in the South, how would the North be affected?

8. Discuss the effect of the population shifts in the United States since 1940 on consumption.

9. Study the recent birth statistics of the United States and make a statement of the apparent effect, if any, of the Second World War on the rate of population growth in this country.

CHAPTER XXI

THE CONSUMER AND NATIONAL POLICY

The government occupies an increasing prominence in economic life and in consequence exerts an influence on the consumption of the people. It provides the means of furnishing certain services which private business would find it unprofitable to supply or which for other reasons it has been judged undesirable to leave in the hands of the businessman. The system of taxation may serve as a vehicle for the transfer of income from the rich to the poor and may modify the relative prices of various goods. In addition, government provides the rules of conduct governing business transactions and maintains conditions determining the nature of the economic order. There is a distinct tendency for the services that the modern state provides for its citizens to increase in number and quality. Public expenditures have been increasing for more than one hundred years. Many services previously poorly supplied now take large sums. Expenditures for education, police protection, sanitation, and public lighting have only recently come to demand large amounts.

1. Government Expenditures and Revenues. Total government expenditures in the United States are expected to approximate $225 per capita for a considerable period of time. The largest spending agency is the Federal government, and this is a development of recent years. Before 1920 Federal expenditures were about one-third of the total with state and local expenditures making up the remainder. During the recent war, however, Federal expenditures reached nearly 90 per cent of the total, and they will continue to constitute at least three-fourths of the total for some time. The continued high level is, of course, due to the war. Data showing the comparative expenditures by the various governmental units are shown in Table 77.

The sources of revenue of the various governmental units differ greatly. The Federal government relies principally upon the income tax, and this is supplemented by customs and excise taxes. The local governmental units rely almost exclusively on the general property tax. The states depend upon property, motor-vehicle, income, business, and license taxes largely. Up to 1933 the principal expendi-

tures of the Federal government were payment for past wars and preparation for future wars, and for state and local governments the principal expenditures were for education and highways, with lesser amounts for protection to persons and property and social relief. Beginning in the 1930's there was a great growth in the expenditure for relief, especially by the Federal government, and of course, with the war, large outlays for the armed forces and subsequent international relief. The usual sources of revenue did not provide sufficient

TABLE 77. ANNUAL EXPENDITURES FOR LOCAL, STATE, AND FEDERAL GOVERNMENTS IN THE UNITED STATES*
(Billions of dollars)

Year	Total	Local	State	Federal
1920	10.6	3.3	0.9	6.4
1925	10.2	5.6	1.5	3.1
1930	12.8	7.2	2.2	3.4
1935	14.7	5.5	2.2	7.0
1940	18.2	5.6	3.6	9.0
1943	87.1	4.6	4.3	78.2

* Postwar Economic Studies, No. 3, "Public Finance and Full Employment," Board of Governors of the Federal Reserve System, p. 115.

funds for the latter expenditures and a considerable portion of them were secured by borrowing.

At the end of 1945 the Federal debt was over 265 billion dollars. This was the largest debt in our history. At the prevailing rates of interest over 5 billion dollars is required annually to pay the interest on the debt, and the source of these funds is necessarily taxes. The annual budget for all Federal expenditures has exceeded this amount only twice in all the years preceding 1934. It is understandable that a public debt of this size should cause some apprehension and that a policy of repayment should be advocated by many.

The economy would, no doubt, be better off without the debt. The government debt has, however, some features which distinguish it from that owed by an ordinary individual. When taxes are collected from one group in the community to pay the interest charges on the debt, these interest payments go to other members of, and institutions in, the community. What is effected is largely a transfer of funds among members of the community. This in turn means that there is no such definite limit to the size of the debt as would be the case with an individual. The burden of the debt depends chiefly on

the income of the community and the proportion of this income transferred in the process. Most students feel that the present debt can be served effectively with a national income of the size to be reasonably expected in the future, assuming that other cost burdens, many of which developed out of the war, do not become too onerous (the military, demands of veterans, etc.). A marked decline in the national income would perhaps make the transfers of income necessitated through the channels of government difficult. If purchasers of new bonds can be found as the old become payable, then there will be no necessity for reducing the debt at all except in so far as this would affect future financing needs.

At first glance it might appear that if everyone held bonds in proportion to the taxes which he was called upon to pay to provide the funds for paying the interest on the bonds, then the existence of the bonds would make no difference at all. But each individual then must be taxed to provide the interest that must be paid on the bonds; thus the bonds in effect are rendered sterile. Actually, of course, the bondholders and those paying taxes are not the same group. Among individuals the larger income receivers are the larger bond-holders. Banks and insurance companies are also important holders of government bonds. The problem that is involved is whether the transfer of funds from the tax-paying to the interest-receiving group will stimulate or retard business activity. In so far as taxes are such as to restrain effort and lessen initiative, and funds are channeled into savings at times when investment opportunities are few, the shift will have a depressing effect. On the other hand, the interest payments and the ready marketability of the bonds might provide funds which in a period of depression or recession would lead to an expansion of business activity.

The ownership of this considerable quantity of marketable securities by the general public is a new circumstance in our history. It provides the public with a potential purchasing power that has not been available to it before. It makes possible an inflation at any time, if the public should choose to cash the bonds and spend the cash thus secured. A great deal thus depends upon the psychology of the public. A general spending spree seems improbable at the present time, but would not be impossible. Gradually retired, the bonds might sustain purchasing power in the market for an extended period of time.

The government necessarily modifies consumption through its system of taxation. This may be because the tax falls unequally upon

the different members of the community and lowers some incomes more than others, or because the relative prices of things are changed. It is, in consequence, pertinent to examine the circumstances under which these taxes may modify consumption and discover which modifications are desirable and which undesirable.

The taxes levied by the government may take different proportions of income from different people. Property is classified for purposes of taxation, and it is common for certain classes to be taxed at a higher rate than others. Even with a general tax, certain property may escape assessment and taxation. Thus it is argued that the general property tax bears most heavily on the farmer. Outside of the rural districts, the great mass of personal property consists of intangibles which as a rule escape taxation almost entirely. In the rural districts, on the other hand, the great mass of personal property consists of visible objects which cannot escape assessment. Another difference arises in the exemption of certain property from the tax. The income tax is not imposed on very small incomes, nor the inheritance tax on very small estates. In most jurisdictions, a small amount of personal property is exempted from the personal property tax. Taxes may also be progressive; *i.e.*, the rate may increase as the base on which the tax is imposed increases in amount. Our income tax is an example. As the amount of income grows larger, the rate of taxation increases. Most commodity taxes are regressive; *i.e.*, they bear more heavily on small than on large incomes, since the proportion of large incomes that is spent is smaller than that of small incomes. Generally speaking this is not considered desirable.

The argument for progression in taxation rests upon the idea that justice in taxation means an equal sacrifice by all members of the community. This would require a larger proportion of the income of the rich to be absorbed by taxes than of the incomes of the poor, since an equal percentage deduction from the income of the poor and the rich means a greater sacrifice to the poor. The difficulty lies in the fact that we cannot set the precise rate of decrease in the significance of income.[1] In the United States, progression has been applied to both income and inheritance taxes.

The effect of taxation does not necessarily remain on those who originally pay the tax. They may be able to include the tax in the price charged for goods or buy some of the materials or services used

[1] Irving Fisher has outlined a method for attempting this in his article, A Statistical Method for Measuring Marginal Utility and Testing the Justice of a Progressive Income Tax, in "Economic Essays Contributed in Honor of John Bates Clark."

in production at a lower price. If this can be done, then the tax is said to be *shifted*, and the settlement of the burden on the ultimate taxpayer is called the *incidence* of the tax. The tax may be shifted forward or backward, or only partly shifted. A payer of a tax will endeavor to shift that tax to others wherever possible. This can be done only when the supply of the commodity is changed. Thus a tax placed on the production of an article can be shifted to consumers in the form of a higher price (1) when it leads to a withdrawal of capital and labor from that field with a consequent reduction in the quantity of the good produced and (2) when producers reduce their output and sell a smaller quantity at a higher price. The former process is the more usual, and the producers may finally be able to shift the entire tax to the consumers. The original incidence of the tax may be felt by the producers for a considerable period of time, because they are not able to withdraw their capital from the business quickly. All capital, however, wears out in the long run; and, when the wearing-out process has begun to reduce the amount of capital, the shifting of the tax will begin. The reduction in supply necessary to raise the consumer's price by the amount of the tax will be small when the demand is inelastic and large when the demand is elastic. In consequence, the tax is likely to be shifted more quickly and more completely when the demand is inelastic.

There are a number of taxes in this country on particular consumable commodities. For example, we have taxes on beverages, tobacco products, automobiles, etc. Generally speaking, mass goods are more convenient and economical objects of taxation from an administrative standpoint than goods purchased in small quantities. Experience shows that a large number of taxes of small amount are relatively far more costly and inconvenient to collect than a few taxes of large amount. Mass goods are purchased largely by the poorer classes, and in consequence these taxes, when they are on necessities, are likely to take a much larger proportion of the income of the poor, and are very undesirable. An increasing number of these levies have recently appeared in the form of state sales taxes. Such taxes, though they are regressive in nature, are productive, inexpensive to administer, and certain; and their regressiveness is offset in the main by progressive features in the remainder of the tax system of which they form a part. Import duties form another sort of commodity tax; their effect has been discussed elsewhere.

Taxes that cannot be shifted are those on objects the supply of which will not be decreased because of the tax. Thus taxes on the additions to the value of people's property that are not foreseen by

them and are not due in any degree to efforts made by them or to capital "invested" by them cannot be shifted. Certain people have argued, in consequence, that the principal source of revenue should be taxes on the so-called *unearned increment* of land values, since these would fall on the unexpected portions of the owners' incomes and, properly placed, would not change the uses of land or the quantities of goods produced.

Taxes on income approach the character of this group of taxes and are particularly desirable forms of taxation from the standpoint of consumers in general. The supply of services will not be diminished unless the taxes are very high, and if the rates are low enough there will not be serious attempts at evasion. Another tax which, in general, affects consumers only indirectly is the inheritance tax. The only objection to such a tax lies in its possible effect upon savings. These effects are probably small, however, and heavy death dues can probably be levied on large estates without causing any considerable check to savings.

Judging from this analysis, we may reach the following conclusions with respect to the principal taxes levied in the United States. The personal income taxes and inheritance taxes are not shifted. This is true also of that part of the general property tax representing the levy against the unimproved value of land. The sales taxes, such as those on gasoline, tobacco, and liquors, are ultimately almost entirely shifted to the consumers. At the outset they fall on the producers, but subsequently are shifted, except for a slight burden on the producers and the owners of land producing these products. The burden of the general property tax in so far as it applies to man-made capital, the corporate income tax levied by the United States government, and the business income and license taxes of the cities and states is divided. An estimate has been made by the Temporary National Economic Committee of the burden of taxes on specified income and occupational groups before the Second World War, and some of these estimates are given in Table 78.

The conclusions of a study made by The Twentieth Century Fund were as follows:

"It seems safe to conclude that the tax system as a whole is regressive for those income groups not subject to income and death taxes. The regressive elements appear to be more numerous and more important than the progressive elements at the lower end of the income scales. It seems safe to conclude, further, that the tax system is progressive for the income groups subject to income and

death taxes, for these taxes dominate all others for the higher groups. It seems safe to conclude, likewise, that no one escapes making a substantial contribution to our tax revenues, however well concealed his share in the burden may be. There are enough shiftable taxes on a wide enough variety of bases to insure this effect. It seems probable that the tax burdens of the higher income groups exceed half their income, unless they are evading taxes illegally. The

TABLE 78. SAVINGS AND ALL TAXES AS A PERCENTAGE OF CONSUMER INCOMES, 1938–1939*

Income class	Taxes as a percentage of income			Savings as a percentage of income
	Federal	State and Local	Total	
Under $500	7.9	14.0	21.9	−24.3
$500–$1,000	6.6	11.4	18.0	−2.0
1,000– 1,500	6.4	10.9	17.3	5.2
1,500– 2,000	6.6	11.2	17.8	5.8
2,000– 3,000	6.4	11.1	17.5	9.6
3,000– 5,000	7.0	10.6	17.6	16.8
5,000–10,000	8.4	9.5	17.9	28.4
10,000–15,000	14.9	10.6	25.5	32.3
15,000–20,000	19.8	11.9	31.7	32.3
20,000 and over	27.2	10.6	37.8	38.3

* Temporary National Economic Committee, Monograph No. 3, "Who Pays the Taxes?" p. 6.

burden will hardly reach this proportion, however, for incomes that do not exceed $1,000,000."[1]

2. State Action and Private Business. There is a great difference of opinion as to how far the state should enter into economic life. The further state action is carried, naturally, the greater the influence on consumption. No one argues that the state should do nothing at all. Certainly it must provide the rules and their enforcement for the operation of business. Likewise certain activities, such as operation of the postal system, fire protection, and education, are generally agreed on as proper state activities. But whether the state should operate utilities, engage in housing activities, direct investment, and enter other businesses are debated questions. Under private business, only those goods and services are produced for which consumers are willing and able to pay a price sufficient at least in the long run to cover the costs of their production. More-

[1] The Twentieth Century Fund, "Studies in Current Tax Problems."

over, these goods go only to those able and willing to pay the going price. Certain services, however, it is believed should be available to all regardless of ability to pay, and certain activities are thought essential to society even though they do not cover their production costs in the market sense. The issue arises as to the circumstances under which the state can better utilize resources than they would be utilized under private enterprise.

If private enterprise is engaged in activities that are detrimental to the public interest, state action is clearly needed and no question is involved of superior competence on the part of the state officials. Many such circumstances are found in the modern economy. This is the case with monopoly where the action of the producers in restricting production is contrary to public interest. The state has a clear case for intervention to force a larger production at a lower price by such methods as may be most expedient. This may be by some form of control, by dissolution, or by direct state operation. The growing monopoly problem in modern society makes it imperative that adequate methods of control be provided. It is clear that these methods are yet to be devised.

We have already indicated that with respect to time the viewpoints of the state and the individual differ. The future is tied to the present for the individual by the length of his life and by his consideration for his own posterity, and even when these ties are strongest they seldom extend beyond the next generation. The state, however, is concerned with its future citizens as well as its present ones. Technically this means that the interest rate for the state will differ from that of the market and, properly, will be lower. There will thus be a tendency for the more rapid utilization of natural resources through private operation than may be felt to be justified by the state and various efforts for conservation will thus be undertaken by the state. Certainly the self-interest of one generation must be prevented from squandering resources that will be essential for the following ones. The same considerations apply to investments for future returns; the lower rate of interest properly applicable to state enterprises permits investments in forest projects, flood control, etc., that would not earn the going market rate of private industry.

Another difference between state and private investment arises with respect to the investment in human resources, which differs from ordinary investment in that the returns from that investment accrue to others than the investor. Thus, unless undertaken by the

state, investment in the rearing and training of laborers will be made because of family affection or by the individual himself. The state, however, has an interest in a strong, well-educated body of citizens and, in consequence, is led to investments in education, recreation, health, sanitation, etc., which no individual could afford to make for others. The advisability of such investment may be extended even to such things as housing and supplementing nutrition in the lower income groups.

It sometimes happens under the economic system that the full costs or damage of a person's action are not assessed against him, nor, conversely, does he always secure a full reward for or the benefit of his action. Thus without legal coercion the industrialist may not find it profitable to surround his workmen with adequate safeguards. Likewise, as Marshall has pointed out, "... the struggle for survival tends to make those methods of organization prevail, which are best fitted to *thrive* in their environment; but not necessarily those best fitted to *benefit* their environment, unless it happens that they are duly rewarded for all the benefits which they confer, whether direct or indirect. And in fact this is not so."[1] An example might be found in some forms of cooperative association.

The interests of the state again become prominent when we consider the maldistribution of incomes. Investment of resources in support of the lower strata will in many cases more than repay in terms of increased total productivity the amounts expended. Certainly expenditures on proper nutrition for mothers and children will avert subsequent illness and loss of working time and improve the quality of the population, not to mention the individual benefits of such a program. Better housing may produce more alert and resourceful workers and lessen the cost of crime prevention. As was previously pointed out, however, a nice judgment is involved as to how much can be taken from the higher income group without leading to a decrease in the total national income. Even greater judgment is required in order to avoid destroying self-reliance on the part of beneficiaries.

In so far as the ends sought by private business are not contrary to the interests of the state, the case for interference must rest upon the assumption that the state can in some ways carry out these operations more effectively than private individuals under the stimulus of a desire for personal income. This assumption is certainly a doubtful one. There is little reason to suppose that the

[1] A. Marshall, "Principles of Economics," 8th ed., pp. 596–597.

state can assemble better administrators than private business. Likewise, state officials are subject to pressures of interests and uninstructed public opinion, which makes action difficult. Moreover, there remains the attitude of the people toward government action. As long as the state and its activity are looked upon as the legitimate prey for all sorts of unscrupulous dealing, state operation must be ineffective as compared with private business.

3. Governmental Responsibility for Purchasing Power. Some sort of failure in the purchasing power of consumers or its allocation among groups has been considered by a number of students as a major cause of our recurring stoppages in the economic system. In line with these views, it is urged that governmental action toward increasing purchasing power or redistributing it is essential to a smooth working of the system. In this respect there has been a profound change in the general public viewpoint regarding the responsibility and function of the government. Before the depression of the 1930's, the role of the government was considered largely as that of an umpire in the working of the economic system—namely, to provide the rules and to see that they were enforced, but with no major responsibilities for economic fluctuations. With the depression and subsequently there has come the growth of a belief that the government has a final responsibility in making the economic system operate to the satisfaction of its citizens. The belief seems to be prevalent that if the economic system does not operate well through businessmen, then the government must step in and provide the means of satisfactory operation.

In popular discussions, purchasing power usually means money, but for our purposes it will be necessary to keep money distinct from real purchasing power as we have formerly defined it in terms of goods and services. If there is an increase in the money incomes of the people with no corresponding increase in the quantity of goods, then the result must be a rise in prices with total purchasing power remaining unchanged. This was, of course, the general situation which we faced in the recent war, but at that time we attempted to restrain the price rise through price ceilings and other price controls. If the increase in money incomes is unequally distributed or falls into the hands of a selected few, then, when prices rise, these may gain in purchasing power, and those whose money incomes remain unchanged or rise less rapidly than the increase in prices lose in purchasing power. Total purchasing power in such a case remains unchanged. There is simply a reallocation of the purchasing power

in the community. It is perfectly natural for any group to feel that not only they but the whole community would be benefited by their larger expenditure, and, in consequence, an increase in purchasing power is argued as a reason for such things as the Townsend plan or a soldiers' bonus.

New money will evidently dissipate itself in a price rise and purchasing power remain unchanged unless it in some way stimulates production. It is, however, possible that the rise in prices or the anticipation of that rise may stimulate production, and consequently, real income or purchasing power may increase. This was evidently the theory under which the government operated its "pump-priming" activities in the depression. The authorities may be able to determine where new money injected into the system is to be spent first, usually through their credit operations, but there is no subsequent control of how the money is used by the successive recipients. A great deal thus depends upon the psychology and anticipations of the businessman, as well as other more fundamental elements that may be present in the particular period. There is therefore no assurance that such procedures will be successful.

One of the causes often cited as making it necessary for the government to pump money into the economic system is technological progress. Technological progress results in an increase in the volume of consumers' goods. If the total quantity of money remains unchanged, we would expect a fall in prices to follow the increase in production. It is now argued that this fall in prices makes it impossible to sell goods at a profit and forces curtailment of output, discharge of workers, and a resulting depression. But in so far as these increases are due to technological improvements, costs will have been lowered. The fall in prices is then necessary to pass the benefits of these technological improvements on to consumers and to increase their purchasing power, and because of the decline in costs there is not necessarily a loss to the producer. There is no reason for gradual technological progress to result in a business depression.

It is also said that the use which the consumer makes of the money in his hands is an important factor in business fluctuations and that much depends upon what is spent and what is saved. Money that is used for the purchase of consumers' goods is presumed to occupy a strategic position, and it is supposed that by the process of saving we somehow lose purchasing power in the community. This notion probably arises because as individuals we tend to contrast

what we spend and what we save. But, in general, when we save money it is usually invested, if not by ourselves, then by the bank or other agency through which we save. When invested, money pays for the production of factories, machines, or whatever a borrowing businessman uses funds for. New capital equipment requires labor and raw materials in its production, and these funds saved are simply transferred to others to be spent in different ways. The saved funds are spent as surely as expenditures made by consumers on shoes or flour. The difference lies in the direction of expenditure. Saving does not necessarily add to unemployment or to a decrease in purchasing power.

It is, however, to be pointed out that saving and investment in new capital equipment do not necessarily occur simultaneously, and idle reserves may be built up in banks or cash hoarded. During a depression when the spirit of enterprise is low, it is quite probable that savings tend to produce deflation and to prolong the slump. During such a period savings exceed new investment because they are used to liquidate bank credit or are hoarded as cash or idle bank deposits. The money spent in the consumers' goods markets declines, and there is no corresponding increase in the capital-goods market. But this is quite a different thing from saying that saving in itself was responsible for the original development of the depression.[1] The government may, of course, step in to spend the amounts that other people are failing to spend, but unless it takes over all of industry it has to rely largely upon creating conditions that make it profitable for businessmen to spend, and here such intangibles as expectations and confidence become important.

A further refinement of the theory that the division of money receipts between consumer expenditure and saving is responsible for depressions places the difficulty not at the time when savings increase but later. The savings which are made in the present find outlet in investment with no reduction in total money to take consumers' goods off the market. But as these investments become productive capital equipment later, the volume of consumers' goods is increased and there is now an excess of goods to be sold unless

[1] G. Haberler, "Prosperity and Depression," p. 116, "There is no evidence that an absorption of savings occurs during the boom or before the crisis; on the contrary, there invariably exists a brisk demand for new capital, signalized by high interest rates. There is an excess of investment over saving and not the contrary. The situation changes, of course, completely after the turning point, when the depression has set in. Then there is an excess of savings over investment."

prices of consumers' goods fall. It is at this time, then, that difficulties are supposed to develop. The increased volume of saving, however, would result in a decline in the interest rate and a lowering of the cost of goods involving much capital. There would thus be no reason for the subsequent fall in prices to produce losses. The fall in prices is in fact necessary to pass some of the gains on to the consumers and to slow up the production of these goods. Whether investment has stopped at the proper point in a particular industry will depend upon the foresight of the entrepreneurs in calculating the results following their investment. It is thus not the fact of saving but errors in investment that produce undesirable results. As long as the changes are gradual, there are no necessary ill effects. Any large change or dislocation of processes in the economic system of course produces its repercussions. A sudden great burst of saving would result in strains; but this is not necessary with any gradual growth or change.

There is finally a group who hold that somehow in the economic process purchasing power is lost and does not reappear in the market for consumers' goods. In the United States, this idea is associated principally with Foster and Catchings.[1] They would argue that industry fails to disburse to wage earners and investors an amount of money equal to the final sales price of its product. This is said to be because a portion of the profits is retained in the business and used to expand productive capacity, rather than being paid out as dividends. In addition the wage earners and investors do not pay out all they receive on consumers' goods but also save part of their income. Most of these savings likewise go into the production of capital equipment. Thus it is argued that some money is used *twice* for production before it is used for consumption, because of the savings by business enterprises and by consumers. The supply of goods thus outruns the money purchasing power of consumers, to the extent that it is used more frequently for production than for consumption. There is alleged in consequence an accumulation of stocks, a collapse of prices, and a depression, during which consumers use up these accumulated stocks at prices below their production costs.

There would be a considerable element of truth to this proposition if all business were one gigantic corporation making a single product, the manufacture of which required a definite period after the public

[1] Also with P. W. Martin of the International Labor Office in Switzerland and Major Douglas of England of social credit fame.

had invested in the enterprise before the results could appear. Actually many processes and products are involved, and the adjustment is gradual and can be made without difficulty by shifts in relative prices provided that savings are not greatly different from formerly. In addition, there are many other factors that are sufficient in themselves to produce business fluctuations, and it is a mistake to attribute them entirely to a single cause such as this.

The majority of competent investigators would appear to hold that there is no necessity for the government to expand money purchasing power in order to maintain a smooth-working economic system. Technological progress, the act of saving by consumers, changes in the rate of saving—none of these necessarily results in money incomes inadequate to clear the market of goods without entrepreneurial losses. There is likewise no failure of the system itself to put into the hands of buyers sufficient money purchasing power for the goods produced by the economic system. The business cycle appears to arise principally from other causes, and the developments with respect to consumer purchasing power appear to be accompanying results. But in view of the time required for the development of productive capital equipment, the institutions between the consumer saving and final investment, and the fixity of certain rates or prices in the system, there are times when increased consumer spending might act to maintain production. There are then, at times, periods when additional money purchasing power may sustain or lead to an increase in production, but these increases of purchasing power are in the form of stimulants designed largely to produce psychological results and there is no necessity for sustained doses.

4. Provision for Higher and More Stable Income. Our previous analysis has shown that there is no general deficiency of purchasing developed by the operation of the economic system necessitating a constant replenishment by the government. This is not to say, however, that there are no possible advantages in an increase in the purchasing power of the low-income groups at the expense of the more well-to-do from a purely ethical viewpoint and possibly in certain circumstances from a productive viewpoint as well. It has been noted elsewhere that consumption has an important bearing upon the quality of the people and that investment in human resources not now made under the existing economic system, might yield larger returns than similar investments in capital equipment. It would appear to be a clear duty of government to maintain as

high a level of consumption for the lower groups of the population as is possible without serious curtailment to the total volume of production and without endangering individual initiative.

One of the most usual proposals is to establish a minimum wage and maximum hours of work, at a level sufficient to provide some desired total income. The Federal wages and hours law is set up along these lines. The wage-hour program aims at a national standard of a minimum wage of 40 cents an hour and a maximum work week of 40 hours. Minimum-wage legislation has had considerable success in improving the position of the lower paid workers in a number of instances. There are, however, limitations to the extent to which it will be successful. The rate of wages of course may be set at any level, but employers may hire any number they wish at that rate. The total income of the laboring class depends upon both the rate of wages and the volume of employment, and the long-run elasticity of demand for labor appears to be quite high.[1] Unless judiciously applied, a law simply imposing higher wage rates is likely to lower rather than raise the money income of the laboring class. Higher wages lead to higher costs, and these higher costs lead to higher prices with curtailed output or to losses and shutdowns. They also result in increased advantages of mechanization and laborsaving devices. The higher prices lower the purchasing power of the other groups. There are exceptions, of course. Where labor is exploited, higher wages may be secured by squeezing profits out of entrepreneurs. These areas of profit are, however, in all probability relatively small. Where the entrepreneurs are inefficient or the industry overexpanded, needed adjustments are hastened, although these will be accompanied by temporarily increased unemployment. If the minimum is sufficiently high to affect more than a small portion of the laboring group, it must lead to increased unemployment. The problem of what to do with these unemployed will then still remain to be faced. Indeed, the situation may become worse, instead of better.

Our present economy not only results in relatively low incomes to a considerable group of persons, but also exposes these and others to the hazard of the loss of income through unemployment and indigent old age. The Social Security Act is primarily an attempted

[1] Paul Douglas by statistical analysis arrives at a figure of between −3.0 and −4.0 ("Theory of Wages," p. 501), while A. C. Pigou through deductive reasoning estimates that it is "probably not less than −3.0" ("Theory of Unemployment," p. 97).

solution of these problems. It provides for unemployment benefits and pensions or benefits for those over sixty-five years of age in certain selected groups. The Act was originally passed in 1935 and drastically amended in 1939, so that we are only at the beginning of our experience with its operation.

The funds from which unemployment benefits are paid are raised entirely by a tax upon employers. Employers of eight or more persons pay a tax of 3 per cent on the wages of each employee up to $3,000 a year. The tax does not apply on amounts paid in wages in excess of $3,000 annually. Agricultural workers, domestic servants, government employees, and those employed in charitable, religious, or educational work are excluded from the provisions of the law. The coverage extends to about three workers out of five. Employers coming under the Act may credit against this tax any amount up to 90 per cent thereof which they have paid to a state government under an unemployment compensation law. The effect of this provision has been to lead states to pass laws imposing taxes on employers equivalent to 90 per cent of the Federal tax. Each state thus has its own unemployment compensation plan, although all the state plans must be approved by the Federal Social Security Board. The benefits paid in the various states differ considerably in detail, but they all provide for the payment of moderate sums to those thrown out of employment. The payments are usually figured at a certain percentage of the previous wages, but are subject to a weekly maximum which in the majority of states is $22. The number of weekly payments that can be received in any year is commonly limited to 20. A waiting period of one week or more, depending upon the state, is required before benefit payments begin. Most of these benefits are based upon previous earnings and in only a few cases is allowance made for the size or status of the recipient's family.

The Social Security Act contains two plans for providing for old-age benefits to persons sixty-five years of age or over. One of these is the old-age insurance plan, which provides a retirement income to those who have made a contribution in the form of a tax on their wages during their employed years. The other is in the form of outright pensions awarded on the basis of need only.

The Old Age and Survivors' Insurance exempts the same classes from its coverage as the unemployment benefits, except that there is no exemption of employers having fewer than eight workers. To provide the funds for this program the workers and employers pay

equal taxes to the Federal government. These are to reach a maximum of 3 per cent from each. With the money so collected the government has undertaken to pay benefits to the contributing workers who have reached the age of sixty-five in 1942 or since and who have retired from active employment. The benefits vary from $10 to $85 a month according to a scheme that takes into consideration the total amount of wages upon which taxes have been paid. The payments are biased somewhat in favor of those who have earned the smaller sums.

If a worker dies before reaching the age of sixty-five, or if he has dependents after retiring, additional benefits are provided. A wife past sixty-five receives one-half of her husband's primary benefit; a widow past sixty-five, or any widow having custody of a dependent child, an amount equal to three-fourths of the primary benefit; for each child under eighteen, one-half the primary benefit; and for each dependent parent left by an insured person who died before retiring, one-half the primary benefit. The total monthly payments on the account of any one individual, however, cannot exceed $85.

The old-age assistance program provides for outright pensions on the basis of need only. In this program the Federal government offers to match state appropriations for relief of persons over sixty-five years of age, by paying up to $20 a month for each person aided. In 1945 over 2 million persons were receiving old-age pensions of this type, amounting to payments of over 50 million dollars a month. The average monthly payment in June, 1945, was $29.46, varying from $11.42 in Georgia to $48.29 in the state of Washington.

These provisions for the greater security of income in the way of unemployment-compensation and old-age benefits are to be highly commended as desirable forward steps. Much of the actual benefit will depend upon efficient and honest administration, which will require time for development. The provisions of the wages and hour legislation also have merit, but as has been pointed out might be disadvantageous both to workers and to consumers if rates are set too high. The provisions for relief are necessarily temporary and to be replaced by other measures if a more permanent group of unemployed develops.

5. International Trade Relations. One very important aspect of national policy directly influencing the consumer is the decision of the state with respect to whether the national policy will be in the direction of self-sufficiency or whether trade is to be sought with

other nations. We have already indicated in Chaper VI that market exclusion is detrimental to the consumer.

When viewed from a social standpoint (taking into account all countries and assuming no barriers already in existence), restrictive barriers are completely untenable. The advantage to be derived from free trade arises from specialization and subsequent exchange. Underlying this is the principle of comparative advantage. Comparative advantage, in its essentials, means that an advantage will follow specialization of effort and subsequent exchange—each country specializing in the thing or things it can produce most effectively even though one country may not be superior in any one thing.

Each country is endowed with certain quantities of labor, natural resources, capital equipment, and industrial "know-how." The productive possibilities of each differ. People could try to produce all commodities in each country, but some commodities would be produced at prohibitive cost, say, bananas in Minnesota. In consequence it pays Minnesota to produce wheat and dairy products and exchange these for bananas which can be produced more cheaply elsewhere.

What is not so obvious, but is nevertheless equally true, is that trade is mutually profitable even though one country has an absolute advantage in the production of every good over another country. As long as there are differences in the relative efficiencies of producing goods in the two countries trade is possible and advantageous to both. Each country should specialize in the commodity or commodities in which it has the greatest comparative advantage. Barriers which prevent production in line with this principle are disadvantageous to consumers of both countries. The sugar tariff may be cited as one of the worst as far as consumers in the United States are concerned. This is a tariff that has cost the consumers at times two or three times as much as it has yielded in revenue, and has yielded the farmers who produced the cane and beets only about one-third as much in farm income as it cost the consumers.

During the past two decades quantitative governmental controls over international trade have increased greatly. The world has experienced a series of emergencies which have had profound influences upon trade—first the disruptions following the First World War, then the great world wide depression, next the Second World War and finally extreme shortages of goods and services following the Second World War. Nearly all governments, whether they liked it or not have felt themselves forced to adopt absolute or

quantitative controls over the movement of goods and services over their national frontiers.

The nations of the world may be divided into three groups with respect to their attitude toward their commercial policies. There are those that favor free private trading; those combining free private trading with controls and a limited amount of state trading; and those with whom state trading is the dominant method. The United States is the principal representative of the first viewpoint. The U.S.S.R. is the other extreme where all international trade is conducted as a state monopoly. The majority of the nations fall in the second group with a combination of controlled private trading mixed with state trading agencies. Currently some nations are moving in the direction of freer private trade and others towards more state controls. The United States has promoted programs directed toward freer private trade, while the U.S.S.R. has sought to incorporate areas into their sphere of trading.

One of the attempts of the United States to provide freer world trade has been through the Reciprocal Trade Agreements Program which was begun in 1934. Under this program the United States representatives and those of one or more other countries sit down together and work out a written agreement that each will reduce certain of its tariff and other trade barriers in return for similar reductions by the other party or parties to the agreement. The purpose of the program is to expand international trade by removing or reducing excessive and unnecessary governmental barriers to such trade. Thirty countries have negotiated reciprocal trade agreements with the United States.

During the major part of 1947 an International Conference on Trade and Employment was held at Geneva, Switzerland. At its close 23 countries signed a general agreement to reduce preferential tariffs, quantitative restrictions, and other barriers to international trade. In 1948 at Havana a charter for an International Trade Organization was adopted. This provides the means by which international trade may be implemented and provides a set of rules for the conduct of this trade. The influence which the organization is able to exert remains to be determined.

In the field of international finance important institutions have also been organized since the Second World War, and these should serve to facilitate trade. The organizations are the International Bank for Reconstruction and Development and the International Monetary Fund. The International Bank has a capital of 9 billion

dollars which has been provided by the leading nations in proportion to their international economic importance. The bank may make loans to people or countries where projects seem economically sound. It may also sell bonds to provide funds for loans and may insure loans of private parties. The bank is expected to be an important source of funds for the large capital investments of the postwar recovery period. The International Monetary Fund is designed to maintain stable exchange rates among trading nations. When exchange rates vary from day to day, the risks of international trading may become sufficiently great to lessen the volume of trading. Also when nations engage in competitive exchange depreciation the ultimate effect is to seriously restrict trade.

The present state of international trade is unsatisfactory. The devastation of the war and the disrupted economic systems have resulted in greatly curtailed production through much of the world. Only as recovery takes place can we expect world trade to resume its prewar volume and importance.

6. Sumptuary Legislation. Regulation of consumption by means of legal enactments has met with little success, and in modern times there are few attempts at such direct regulation. Such legal enactments, or sumptuary laws, have generally been directed along two lines, the maintenance of class status by prohibiting the use of certain articles by others than those of a particular class and the prevention of the introduction of new sorts of consumption. For example, in the later Middle Ages, knights were permitted to wear gold, but esquires only silver; the former damask, and the latter satin or taffeta.[1] The Scottish parliament in 1477 legislated that no merchant or his wife should wear clothes of silk or costly scarlet gowns. Laborers and husbandmen and their wives were limited to garments of cloth of their own make or of a value not in excess of elevenpence per clue.[2] During the nineteenth century, Japan tried similar sumptuary legislation and found it impossible of operation. Efforts were made in the sixteenth century to prevent the introduction of brandy, in the seventeenth, of tobacco, and in the eighteenth, of coffee. Governments shortly discovered the fruitlessness of their efforts toward such prohibitions. For example, a Turkish law of 1610 provided that all smokers should have their pipes broken against their noses. A Russian law of 1634 prohibited

[1] WILHELM ROSCHER, "Political Economy," Book IV, Chap. II, Sec. 234, Note 3.

[2] C. ROGERS, "Social Life in Scotland," vol. I, p. 83.

smoking under penalty of death. Similarly the use of coffee was prohibited in Turkey in 1633 under pain of death. As late as 1780, there was a Hanoverian prohibition of coffee trades in the rural districts.[1]

In the United States, such regulations have been restricted to the prohibition of only a few things generally acknowledged harmful. Thus we have laws limiting the use of narcotics to medicinal purposes. The prohibition laws with regard to liquor were widely violated and were later repealed.

Questions

1. Has the government any policy with respect to consumption? Is it politically possible for it to have any?
2. It is proposed to limit the working week to 30 hours. What influence, if any, would this have on consumption? Might your answer be different if the measure were considered as temporary rather than permanent?
3. Suppose the costs of shipping wheat to Europe were considerably lowered by the development of the Great Lakes Waterway. Who would derive the benefits?
4. A contemplated law in a Western state would pay all over fifty years of age $30 each Thursday. What economic results would follow?
5. Are the principles that underlie proper governmental expenditure different from those for an individual business organization?
6. If it is necessary to raise new governmental revenue, what forms of taxation do you think will be most probable? Most advantageous?
7. Consider the question of the advisability of socialized medicine from the point of view of the consumer and make a statement covering its strong points and weaknesses.
8. It has been suggested that recovery could be hastened in Europe and the prospects for the peace strengthened if we would export our production "know-how" or technical knowledge. Would this be practicable? How far would it go toward raising transatlantic consumption levels?
9. How does a great war affect consumption in the short run? In the long run? Be as specific as you can in formulating your answers.

[1] ROSCHER, *op. cit.*, Book IV, Chap. II, Sec. 235, Note 1.

CHAPTER XXII

CRITIQUE OF CONSUMPTION

It is evident from the foregoing discussion that in no part of the world is the level of consumption sufficiently high so that concern with respect to it may be disregarded. Even in as rich a country as the United States there are large groups with levels that are depressingly low. The studies of family expenditures disclose vast potential demands for goods. At each successive income level, families are found to spend more for food, clothing, and shelter as well as the comforts and conveniences of life. These people would consume goods far in excess of our present productive capacities if given the opportunity. The power of the individual to consume is determined pretty largely by his personal money income. For society as a whole, however, it depends upon the volume of production. A fundamental proposition which we must keep before us at all times is that our volume of consumption is limited by our volume of production. At present this production, unfortunately, is not sufficiently large in any country of the world to provide the inhabitants with a very adequate level of consumption even though income were equally distributed. The solution to the consumption problem even in a country such as the United States is not to be found in a redistribution of the income from current production or in a sharing of wealth but lies much deeper in the necessity for a larger total volume of production. This cannot be too strongly emphasized.

The events of the Second World War and the period following have served to demonstrate these points. Throughout much of the world the close of the war found consumers with a lower level of consumption than when the war began. There were wild inflations and unstable governments in many places. These together with the war destruction and the breakdown of transportation and trade lowered production greatly. The major postwar problem has been to get world production up to its maximum level. The United States, because of its great productive powers, has participated in important international programs directed toward the relief and recovery of these war-torn areas.

Even in a country with as large a volume of production as the United States, it is evident that consumption is not carried on in the best manner. Much of it is foolish and wasteful, and some is actually harmful and degrading. Perfection is not to be expected, but great improvements can be made and these are well worth striving for. Some of the errors in consumption are due to the nature of the economic order in which the consumer finds himself, some are due to imitation of the consumption of others without proper allowance for the differences in the circumstances under which consumption takes place, and others are due simply to a lack of knowledge on the part of consumers and to a lack of pride in efficient consumption.

The greatest handicap that the present economic order places upon consumers is that it brings into conflict the interests of producers and consumers. Producers voluntarily modify their conduct to the consumers' advantage only when such modification furthers their private ends. If it were not for the necessity of future sales, in most cases the selling of goods would proceed on an absolutely unscrupulous basis. The consumer would be cheated or sold shoddy goods whenever possible. Even the necessity of future sales does not completely protect him. He suffers a disadvantage because in many cases he does not know what he needs and, in consequence, is susceptible to suggestion by advertising and salesmanship; and also because, even though he may know what he needs, he is unable in a great many cases to tell whether the thing he is purchasing will perform in the manner he expects, or is led to expect, at the time of purchase. As long as the consumer is unable to judge the performance of commodities before their purchase, he will be sold commodities unsuited to his needs and of lower qualities than he believes himself to be buying.

One of the most elementary rights to which the consumer is entitled is to know the truth about the goods that he buys. In our existing society the consumer is given relatively little opportunity to obtain such information. One remedy for this situation lies in increased standardization of commodities and of commodity performance. These standards must be worked out from the viewpoint of the consumer and must mean definite things regarding the services of the commodity for him. The problem is tremendously complex and difficult. Some progress is being made at present, but it is not sufficiently rapid. There is need for a large foundation or government department with ample funds for research and with fearless direction. The

enmity of powerful producers must inevitably be incurred. The savings that a regime of further standardization would effect are great. There would be a saving in the better ordering of consumption on the part of the individual consumers. There would also be a great saving in the effort expended upon advertising and selling. An advertiser would have greater difficulty in picking out some point irrelevant to the performance of his product and in building a sales appeal upon it. Moreover, competition would proceed more nearly upon the merits and price of the article than it does at present. Those producers delivering the greatest quality of product at the lowest cost would gain distinct advantages, at the expense of those producers who are efficient advertisers and sellers rather than producers. All this should result in some reduction in the price of products to consumers.

Another fundamental right of the consumer should be the right to purchase goods from the cheapest possible source. The extent of monopoly elements in the economic system has been fully recognized only recently. The growth of monopolies and the necessity for their successful control have become a major problem, and in the minds of many their control is essential for the preservation of the present order. It is certain that from the viewpoint of the consumer there can be little justification for market exclusion. Frequently technical conditions are such that, because of decreasing cost, size produces a monopoly. Such monopolies are desirable and are to be encouraged as a means of increasing the volume of production. A means must be found to prevent the resulting savings in cost from being retained solely by the producer and to force the sharing of this excess with consumers in the form of lower prices. Satisfactory means for monopoly control are not in existence now, and the direction that these controls will take is not clear. The growth of monopolies, however, demands that adequate controls be found. Yet it is not to be thought that all these controls need be of a negative character. Under proper guidance, the monopoly may have considerable possibilities for social betterment through discriminative action among groups of consumers.

The order places special handicaps upon particular groups of consumers by limiting their money income. This is not in itself a general consumption problem but rather a problem in welfare economics. Whether these persons are to be provided with larger incomes is a matter of political and ethical expediency. Total income, as has been emphasized, is not sufficient to raise the income of everyone to even a moderate level without seriously endangering the total volume

of production. Increased production rather than redistribution of income is the solution to the consumption problem of the masses. This means that the problem is much broader than consumption economics and involves such things as the means of lessening industrial fluctuations, provisions for increasing the health and education of children, rehabilitation of the industrially unfit, and provision for aid in old age and sickness. We do, however, possess sufficient income in our present stage of progress to warrant minimum levels in several lines below which the state has an obligation to see that no one falls. One of these is nutrition, especially that of children. We have ample production of food and ample total income to provide all with a minimum diet adequate to maintain health and strength. Some other countries are not so fortunate. To a more limited degree, this is also true of housing and medical care and health service.

The consumer himself is responsible for some of the errors in consumption. Some errors for which consumers are responsible arise from our imitation of the consumption of others. Fashions are the most striking example. Rapid changes in fashion are costly from the standpoint of both the manufacture and the distribution of products. They are costly to consumers in that they lead to the discarding of a great many goods before these goods have furnished all the services they might provide were it not for the change in fashion. These goods, moreover, derive their values in a particular manner: they are chiefly valuable because everyone cannot have them and, when everyone does, they cease to be valuable for this very reason. Some progress may be made in this respect if the rich and powerful can be shown their social responsibility in consumption and can be led to promote the consumption of articles that, in themselves, possess intrinsic values rather than solely prestige values. Unfortunately, there is no very great probability that this can be accomplished. The greatest hope lies in educating the lower strata to see the senselessness of the consumption of many of the goods consumed for their prestige value, and in putting emphasis upon the desirability of individuality in consumption rather than of being simply members of the herd.

Consumption is also inefficient simply because of a lack of intelligent attention to the problem by consumers themselves. There is great need for the development of a pride in efficient consumption. The businessman takes a distinct pride in the conduct of his business, the sportsman in the excellence of his performance, and, in a similar manner, there is need of a pride in the efficiency of consumption.

Before such a pride can be developed, objective tests of what constitutes effective consumption will need to be developed. These tests are largely technical matters. They will need to be worked out by our various research agencies. Our colleges of home economics are making notable progress in this respect but are so limited in funds and personnel that sufficient progress cannot be made without national assistance. The increasing emphasis upon the problem in our schools and colleges is a step in the right direction. Each student should receive specific instruction upon the problem of personal finance, tests by which the consumer may judge the quality of goods, the advantages of standardization, etc.

The opportunities for wasteful expenditure increase rapidly as the income rises above the minimum of subsistence level. Our increasing power over productive resources and our rising level of income are complicating rather than simplifying the problem of efficient consumption. We must look forward to a loss of much of this gain in productive efficiency through poorly ordered consumption unless consumers, in general, can be educated to better modes of consumption and stimulated to a pride in efficient consumption.

Any extension of the economic activities of the state or an increase in the amount of central planning necessitates increased attention to the problem of consumption. Whatever else may be the fault of the present economic system, it does have the merit of providing a rapid registration of changes in demand by those who possess the means of purchase. Goods cannot long be produced that consumers do not wish to buy. The rewards for anticipation of shifts in wants or new desires are so immediate and swift that great energy goes into their study. The substitution of collective for individual decision imposes upon those who mold that collective decision grave responsibilities for offering consumers a proper range of choice. A program of uniformity of consumption for all individuals can hardly be supported in view of the recognized differences among these individuals. A certain fluidity over time is required, and proper or best consumption is a changing thing. More knowledge than we now possess is essential before state guidance of any considerable magnitude is feasible.

Questions

1. In what ways would the intrusion of the state into business involve problems of consumption?
2. One writer has argued that profits are no longer a desirable form of motivation for our economic order since they are now largely derived from monopolistic

positions resulting in curtailed production and from superior advertising, rather than from cheaper production of better quality goods. Would you agree?

3. How would you suggest developing in the community a pride in good consumption?

4. What faults or errors in consumption are the result of the inherent characteristics of the consumer himself, and what are to be laid to the economic order? Which bulk larger? Which are subject to remedial action?

5. When one considers the philosophy of Thoreau and others, one may conclude that the attainment of a higher level of consumption is only one way of balancing desires and satisfactions—that one may attain the same end by cultivating the simple life with its restricted worldly goods requirements. Discuss the practicability and the possible economic results of such a plan.

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